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In the Supreme Court of the United States

OCTOBER TERM, 1989

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

UNITED DISTRIBUTION COMPANIES, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission has statutory authority to raise the price of "old gas" under the Natural Gas Policy Act of 1978 in conformity with the express statutory requirements that the increase be by "rule or order" and such new price be "just and reasonable within the meaning of the Natural Gas Act."

2. Whether the Commission correctly concluded that the Natural Gas Act permits the Commission to prescribe conditions under which abandonment of services is authorized on a generic basis, rather than requiring case-by-case adjudication.

3. Whether the court of appeals erred in requiring the Commission to deal in this proceeding with the so-called "take-or-pay" issue concerning certain natural gas contracts, which the Commission had elected to address in on-going separate administrative proceedings.

PARTIES TO THE PROCEEDINGS

The petitioner is the Federal Energy Regulatory Commission. The respondents are listed in App. D, *infra*, 83a-86a.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the Federal Energy Regulatory Commission, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-60a) is reported at 885 F.2d 209. The orders of the Federal Energy Regulatory Commission are reported at 51 Fed. Reg. 22,168 (1986), and 51 Fed. Reg. 46,762 (1986).

JURISDICTION

The judgment of the court of appeals was entered on September 15, 1989, and a petition for rehearing was denied on December 15, 1989. App., *infra*, 61a-62a. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Sections 4(a) and 7(b) of the Natural Gas Act of 1938, 15 U.S.C. 717c(a) and 717f(b); Sections 104 and

106 of the Natural Gas Policy Act of 1978, 15 U.S.C. 3314 and 3316; and the regulations affected by the Orders of the Federal Energy Regulatory Commission are reproduced in pertinent part at App. C, *infra*, 63a-82a.

STATEMENT

A divided panel of the court of appeals in this case invalidated two related orders of the Federal Energy Regulatory Commission that were issued in 1986 to address the serious dislocations that had developed in the natural gas market as a result of the pricing structure that was then in effect for "old" gas. "Old" gas is natural gas that was already in production and subject to regulation under the Natural Gas Act of 1938 (NGA), 15 U.S.C. 717-717w, on the date of enactment of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*

A. Historical Background

1. Prior to enactment of the Natural Gas Policy Act of 1978, the sale and transportation of natural gas in interstate commerce were regulated by the Commission (and its predecessor, the Federal Power Commission) exclusively under the Natural Gas Act of 1938. Section 4(a) of the NGA provides that all rates and charges received by a natural-gas company for or in connection with the transportation or sale of natural gas shall be "just and reasonable," and any rate or charge that is not just and reasonable "is declared to be unlawful." 15 U.S.C. 717c(a); see also § 5(a), 15 U.S.C. 717d(a) (authorizing Commission to fix rates if it finds them to be unjust or unreasonable). Soon after the NGA was enacted in 1938, this Court held that the NGA did not bind the Commission "to the use of any single formula or combination of formulae in determining rates," and that "[u]nder the statutory standard of 'just and reasonable,' it is the result reached not the method employed which is controlling." *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

As the Court explained in *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 327-330 (1983), the Commission's regulation under the "just and reasonable" standard of the NGA underwent a succession of changes between 1938 and the enactment of the NGPA in 1978. The Commission first adopted a company-by-company approach, based on the historical costs of service for each company. This Court sustained that approach in *Hope Natural Gas*.

The company-by-company, historical-cost approach proved to be unworkable, however, especially after *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954). There, the Court held that the NGA required the Commission to regulate natural gas pricing not only downstream, at the end of interstate pipelines, but also upstream, at the wellhead. *Phillips Petroleum* thus required the Commission to institute regulation of the rates charged by thousands of individual producers, in addition to the relatively small number of pipelines. See *Mid-Louisiana Gas*, 463 U.S. at 328-329; App., *infra*, 3a-4a & n.7. In response, the Commission moved to an "area rate" approach, which established rates for all producers in a given region, based on the region's average production costs, investment, and rates of return. At the same time, the Commission instituted a two-tier pricing system, which set ceiling prices for the gas produced in a region according to the "vintage" of the gas. Under this system, the Commission prescribed lower price ceilings for flowing gas ("old gas") and higher ceilings for gas produced from new wells ("new gas"). The higher maximum rate for new gas was intended to furnish an incentive for production. The lower maximum rate for old gas, by contrast, was based on the premise that "'price could not serve as an incentive'" for the production of already-flowing gas, and, accordingly, that "'any price above average historical costs, plus an appropriate return, would merely confer windfalls.'" *Mid-Louisiana Gas*, 463 U.S. at 329 (quoting *Permian Basin Area Rate Cases*, 390 U.S. 747, 797 (1968)); see App., *infra*, 4a-

5a. In *Permian Basin*, this Court sustained the Commission's approach, while again stressing that the "just and reasonable" standard of the NGA did not require the Commission to follow any particular regulatory formula or methodology. 390 U.S. at 775-777, 799-800.

By the early 1970s, it became clear that the area rate approach, based on historical costs and a two-tiered rate structure, "was not working" and "had led to serious production shortages." *Mid-Louisiana Gas*, 463 U.S. at 330. The Commission therefore shifted to a "national rate" approach, which became effective for all wells drilled after January 1, 1973. *National Rates for Natural Gas* (Opinion No. 699), 51 F.P.C. 2212 (1974); see *Mid-Louisiana Gas*, 463 U.S. at 330. "A few months later, the Commission responded further by shifting from a pure historical-cost-based approach to an incentive-price-based approach". *Ibid.* (citing *National Rates for Natural Gas* (Opinion No. 699-H), 52 F.P.C. 1604, 1615-1618 (1974), aff'd *sub nom. Shell Oil Co.* v. *FPC*, 520 F.2d 1061 (5th Cir. 1975), cert. denied, 426 U.S. 941 (1976)). The Commission also temporarily abandoned the practice of vintaging in 1974. 463 U.S. at 330 (citing Opinion No. 699-H, 52 F.P.C. at 1636). Although "the Commission decided to return to vintaging" in 1976 (463 U.S. at 330 n.10, citing *National Rates for Natural Gas* (Opinion No. 770), 56 F.P.C. 509 (1976), aff'd *sub nom. American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016 (D.C. Cir. 1977), cert. denied, 435 U.S. 907 (1978)), it consolidated a number of the older vintages into a single category, comprised of all gas flowing prior to January 1, 1973. *National Rates for Natural Gas* (Opinion No. 749), 54 F.P.C. 3090 (1976), aff'd in part *sub nom. Tenneco Oil Co.* v. *FERC*, 571 F.2d 834 (5th Cir.), cert. dismissed, 439 U.S. 801 (1978).

2. The national rate approach also proved to be insufficient for solving the various problems in the distribution of natural gas. Within a few years, the national rate structure led to ceiling prices for interstate sales that were considerably below what the gas could command in the intrastate market, which was not federally regulated.

That disparity soon resulted in severe curtailments in the Nation's interstate gas supply. Congress responded to this situation by enacting the Natural Gas Policy Act of 1978. *Mid-Louisiana Gas*, 463 U.S. at 330-331; *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409, 420-421 (1986) [*Transco*]; App., *infra*, 6a-7a.

In the NGPA, Congress brought interstate and intrastate natural gas wellhead sales under a single "national market price regulatory scheme." *Transco*, 474 U.S. at 421. The NGPA establishes price ceilings for natural gas depending largely upon when the gas was first produced: higher ceiling prices are prescribed for new or hard-to-produce gas (§§ 102, 103, 105, 107 and 108, 15 U.S.C. 3312, 3313, 3315, 3317 and 3318), while lower ceilings generally are provided for gas that was already committed or dedicated to interstate commerce on November 8, 1978, the effective date of the NGPA (and for certain gas under "rollover contracts" [1] that was not committed or dedicated to interstate commerce on that date).[2]

---

[1] The term "rollover contract" is defined to mean a contract entered into on or after November 9, 1978, for the first sale of natural gas that was previously subject to a contract that expired at the end of a fixed term specified in the contract itself. 15 U.S.C. 3301(12).

[2] As this Court described the statutory scheme in *Mid-Louisiana Gas*, 463 U.S. at 333:

> In each category of gas, the statute explicitly establishes an incentive pricing scheme that is wholly divorced from the traditional historical-cost methods applied by the Commission in implementing the NGA. The price is established either in terms of a dollar figure per million Btu's, or in terms of a previously existing price, and is inflated over time according to a statutory formula. See § 101. For three categories of gas, the statute recognizes that the ceiling may be too *low* and authorizes the Commission to raise it whenever traditional NGA principles would dictate a higher price. See §§ 104, 106, and 109. The Commission is also given a somewhat ambiguous mandate to authorize increases above the ceiling for the other five categories. See § 110(a)(2). In none of the eight categories, however, is the Commission given authority to require a rate lower than the statutory ceiling.

Sections 104(b)(1) and 106(a) of the NGPA furnished the initial price ceilings for old gas under the NGPA by carrying forward most of the prices that had previously been set by the Commission under the NGA, but adjusted monthly by an inflation factor. 15 U.S.C. 3314(b)(2), 3316(a). See 18 C.F.R. 271.101 (Table II). When the NGPA was enacted, there were 15 different vintage ceiling prices, ranging from a low of 33.2 cents per million Btu's to a high of $1.630 per million Btu's. 18 C.F.R. 271.101 (Table II). It was those ceilings that were carried forward for the time being by Sections 104(b)(1) and 106(a) of the NGPA. The NGPA also recognizes, however, that this "ceiling may be too *low* and authorizes the Commission to raise it whenever traditional NGA principles would dictate a higher price." *Mid-Louisiana Gas*, 463 U.S. at 333. Specifically, Sections 104(b)(2) and 106(c) both authorize the Commission, "by rule or order," to prescribe a "higher" price for old gas, "if such price is * * * just and reasonable within the meaning of the Natural Gas Act." 15 U.S.C. 3314(b)(2), 3316(c).

Although the NGPA "comprehensively and dramatically" changed the wellhead price regulation of natural gas sales, *Mid-Louisiana Gas*, 463 U.S. at 322, it left unaltered the Commission's authority under the NGA to regulate the non-price features of sales of gas "committed or dedicated" to interstate commerce before the NGPA was enacted ("old" gas). Of particular relevance here, the NGPA did not abrogate the requirement of the NGA that old gas must continue to flow in interstate commerce unless the Commission authorizes "abandonment" of that service pursuant to Section 7(b) of the NGA, 15 U.S.C. 717f(b).

B. Order No. 451 And The Proceedings In This Case

The NGPA went far to remedy the disparity that had developed between the interstate and intrastate natural gas markets under the NGA. In addition, the higher prices permitted by the NGPA led to increased production, which alleviated shortages. Nevertheless, as the majority

below correctly pointed out, the "natural gas market became fraught with distortions." App., *infra*, 9a. For example, although the greater production fostered by the NGPA led to excess supply, prices paid by customers actually increased. Furthermore, the lower ceiling prices for old gas that were carried forward for the time being under the NGPA fostered premature abandonment and inadequate development of extensive reserves of old gas, even though the marginal cost of producing the old gas was often less than the marginal cost of producing new gas. The resulting shift to new gas caused higher prices for consumers and created incentives to import oil and gas. Against this background, and in response to recommendations by the Secretary of Energy made pursuant to 42 U.S.C. 7173(a) (see 50 Fed. Reg. 48,540 (1985)), the Commission initiated rulemaking proceedings in November 1985 to revise the pricing system for old gas. After reviewing extensive comments filed by all segments of the natural gas industry and others, the Commission issued Order No. 451, at issue here, in June 1986. 51 Fed. Reg. 22,168. Thereafter, in Order No. 451-A, which was issued on rehearing in December 1986, the Commission reaffirmed the basic approach of Order No. 451, while modifying certain of its details. 51 Fed. Reg. 46,762.

1. a. Based on the voluminous record of the rulemaking proceedings, the Commission concluded that the maximum lawful prices for old gas should be raised, because the vintage prices "fail[ed] to assign a reasonable share of the replacement cost or marginal cost of new supplies to purchasers of old gas" (51 Fed. Reg. 22,170). The Commission made several critical findings in this regard. First, it agreed with the Secretary of Energy and other commenters that valuable supplies of inexpensive old gas that remained subject to the price ceilings carried forward under Sections 104(b)(1) and 106(a) of the NGPA were being inadequately developed or prematurely abandoned, and that raising old gas prices would encourage the recovery of an additional 11 trillion cubic feet of such gas that would otherwise be permanently lost. 51 Fed. Reg. 22,170, 22,172, 22,180, 46,774-46,778. Second, the Com-

mission determined that the vintaged prices, as then preserved, kept this gas priced well below the competitive market price for wellhead sales of higher priced new gas, and thereby created an artificial and unfair competitive advantage for those pipelines having access to large supplies of old gas and for the regions and customers served by those pipelines. *Id.* at 22,172, 46,766. As the Commission put it: "This means consumers, purely by the accident of vintaging, pay different gas prices for reasons wholly unrelated to the value of the commodity or the cost of replacing it." *Id.* at 22,172.[3] Third, it found that the low prices for old gas further distorted the market by permitting producers having a cushion of old gas to roll-in their prices of new and deregulated gas with artificially low-old gas prices, thereby enabling them to charge a higher, disguised price for new and deregulated gas. *Id.* at 22,172, 46,765-46,768.

The Commission thus found that the then-existing price structure for old gas was "the major cause of the market distortions identified by the Commission," and it accordingly determined that the price ceilings for old gas were unjust and unreasonable within the meaning of the NGA. 51 Fed. Reg. 22,182, 46,765-46,766. The Commission further concluded that "the current problems being experienced in natural gas markets would largely be remedied by collapsing vintages and raising ceiling prices of below-market priced gas." *Id.* at 22,182; see also *id.* at 46,766-46,767. The Commission therefore decided to consolidate the 15 vintage categories into one category, which would be subject to a single ceiling price based on the highest vintage ceiling price then in effect (for gas having a post-1974 vintage), adjusted monthly for inflation. *Id.* at 22,183-22,185; see 18 C.F.R. 271.402(c)(3)(iii) and (7), 271.602(a)(3). In explaining its selection of this ceiling, the Commission reasoned

[3] The Commission noted that as a result of these differences in access to old gas, the average residential price of gas in 1984 in Washington, D.C., was $8.05 per Mcf, while in Kansas it was $4.49 per Mcf. 51 Fed. Reg. 22,172.

that the ceiling price for old gas should approximate as closely as possible the replacement cost of that gas, in order to assure an adequate long-term supply. Because the ceiling price for post-1974 vintage gas had been adjusted for inflation since April 1977, the Commission concluded that the ceiling as so adjusted (which stood at $2.57 per MMBtu in June 1986) approximated replacement cost, and therefore was "just and reasonable" within the meaning of the NGA. *Id.* at 22,183-22,190, 46,768, 46,771-46,774. This single ceiling price for old gas, based on the post-1974/pre-NGPA vintage, also was below the ceiling prices for post-NGPA ("new") gas.

The Commission further explained that its revised pricing system for old gas is consistent with the overall plan of the NGPA to foster a competitive market for wellhead sales, in order to assure an adequate supply of natural gas at reasonable prices. In the Commission's view, substituting replacement-cost pricing for vintage pricing would further this objective by permitting producers to bargain for a price up to replacement cost and, by operating in tandem with the NGPA's pricing system, would "reduce overall consumer costs" and thereby "benefit the public interest." 51 Fed. Reg. 22,194. The Commission acknowledged that the single new ceiling price for old gas exceeded the then-prevailing market price. But it estimated that an additional 11 trillion cubic feet of old gas would be produced under the new pricing regime (*id.* at 22,190-22,194), and it projected that in the long term, market forces would result in still *lower* (and more stable) prices overall, as more of the relatively low-cost old gas competed with new and deregulated gas. *Id.* at 22,194-22,204, 46,779-46,784. The Commission noted that this projection was supported by the fact that the price of decontrolled gas was falling and that the price of gas regulated by other sections of the NGPA sold for prices substantially below the statutorily prescribed ceilings. *Id.* at 22,195-22,198.

b. The Commission recognized that many existing contracts contained indefinite price-escalation clauses, under

which the price the purchaser was obligated to pay could rise to the maximum lawful price allowed by the Commission under the NGA and NGPA. In the Commission's view, producers that were parties to such contracts should not automatically receive the new ceiling price, because the ceiling would then become a floor and the market would again become distorted. 51 Fed. Reg. 22,204. Accordingly, Order No. 451 institutes a "Good Faith Negotiation" (GFN) procedure to ensure that "all old gas [is] priced at the *lower* of the market or the ceiling price" (*Ibid.* (emphasis added)). See generally *id.* at 22,204-22,209, 46,784-46,802. Under the GFN procedure, which is codified at 18 C.F.R. 270.201, a producer may request a purchaser to propose the price at which it would be willing to continue to purchase old gas under the existing contract. The purchaser then has the prerogative not only to propose such a price, but also to request the producer to propose a price at which it would be willing to continue sales of any gas (old or new) under other contracts that cover both old and new gas. If the producer and pipeline are unable to agree on a new price, the producer may sell the gas to a new customer and thereafter abandon its existing contract service obligations. 18 C.F.R. 157.301.

c. Finally, the Commission rejected suggestions by some commenters that it should use Order No. 451 as the vehicle for a comprehensive resolution of various issues raised by so-called take-or-pay clauses in natural gas contracts.[4] It pointed out, however, that the GFN process would have the salutary effect of causing many of those contracts to be renegotiated. 51 Fed. Reg. 22,174-22,175, 22,183, 22,196-22,197, 46,783-46,784.

2. The private respondents herein, which are purchasers of natural gas (principally pipelines), then sought review of Order No. 451 (as modified on rehearing by Order No. 451-A) in the United States Court of Appeals for the Fifth Circuit. With one exception, respondents

[4] Such a clause requires a pipeline to take a specified volume of gas from a producer or, in the event it is unable to do so, to pay for the specified volume. App., *infra*, 29a; *Transco*, 474 U.S. at 412.

did not seek a stay of the Order pending review, and the court of appeals denied the application filed by the one respondent that did seek a stay (Williams Natural Gas Company). As a result, the new pricing system established by Order No. 451 was permitted to go into effect, and it has remained in effect since that time.

a. On September 15, 1989, a divided panel of the court of appeals held Order No. 451 invalid and vacated the Order in its entirety. App., *infra*, 1a-60a. The majority expressly did not suggest that the Commission was "misguided" in its conclusion that the disorder in the natural gas market had resulted, at least in part, from the vintage-pricing structure for old gas, *id.* at 20a, and the majority did not overturn the Commission's finding that the higher ceiling price for old gas under Order No. 451 was "just and reasonable" within the meaning of the NGA. But even though Sections 104(b)(2) and 106(c) of the NGPA expressly authorize the Commission to set a "higher" maximum lawful price for old gas, as long as it is "just and reasonable within the meaning of the Natural Gas Act" (15 U.S.C. 3314(b)(2), 3316(c)), the majority held that the higher ceiling price for old gas under Order No. 451 was unlawful. App., *infra*, 16a-23a.

The majority dismissed the Commission's reliance on the express authorization in Sections 104(b)(2) and 106(c) to set higher rates that are "just and reasonable" as a "somewhat ingenious application of the plain meaning rule of statutory construction" (App., *infra*, 21a (footnote omitted)). It believed that Sections 104(b)(2) and 106(c) should instead be read to confer only "limited authority" on the Commission, and would be "more appropriately interpreted as special relief measures to be utilized in the event that existing congressional ceiling prices become confiscatory." App., *infra*, 22a-23a & n.24. The majority did not point to any statutory language that confines the Commission's authority under Sections 104 and 106 in this manner, and it made no mention of its obligation under *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837 (1984), to defer to the Commission's interpre-

tation of its authority. Rather, in rejecting the Commission's approach, the majority relied solely on floor statements by several Members of Congress concerning the general policies of the NGPA to protect consumers while furnishing production incentives. App., *infra*, 17a-20a & n.22. In its view, those floor statements indicated that Congress intended to concentrate the rewards of higher prices on the development of new, high-cost gas, and did not authorize the Commission to "break[] virgin ground" under the just and reasonable standard by "abrogating the vintage pricing structure" for old gas. *Id.* at 22a-23a & n.24.

The majority also invalidated the provisions of Order No. 451 that permit a producer to abandon existing service obligations if the parties do not agree on a new price under the GFN procedure and the producer contracts to sell the gas to a new purchaser. App., *infra*, 24a-28a. The majority acknowledged that the District of Columbia Circuit had found " 'no procedural objection' " under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to the Commission's identification of circumstances, in an otherwise valid rulemaking, " 'which automatically triggered its approval of abandonment,' " and had found it " 'well-established that the Commission need not hold an evidentiary hearing when no issue of material fact is in dispute.' " App., *infra*, 26a (quoting *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1015 n.17 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), and *Kansas Power & Light Co.* v. *FERC*, 851 F.2d 1479, 1484 (D.C. Cir. 1988)). But the majority nonetheless believed that the Commission in this case "ha[d] abdicated its responsibility under Section 7(b) of the NGA" by providing abandonment authorization on a generic basis. App., *infra*, 28a. Moreover, although the Commission pointed out that under Order No. 451, "prior abandonment approval has, in fact, been granted by the Commission," the majority believed the Order was inconsistent with *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529 (1979), which reversed an appellate decision permitting

a producer to abandon sales *without* prior Commission approval. App., *infra*, 27a-28a.

Finally, the majority concluded that the Commission erred in failing to resolve the problem of high-cost take-or-pay contracts in the context of Order No. 451, even though it recognized that the Commission was addressing that problem in separate proceedings on Order No. 436, as required by *Associated Gas Distributors* v. *FERC*, *supra*. App., *infra*, 29a-32a. The majority was also unpersuaded by the Commission's finding that the GFN procedure would ameliorate the problem in the context of Order No. 451. *Id.* at 31a-32a. In the majority's view, the GFN procedure is too "one-sided" because it is initiated by the producer (*ibid.*), although the majority elsewhere acknowledged that in the absence of the GFN procedure, a producer could automatically receive the higher ceiling price under a price-escalation clause. *Id.* at 29a.[5]

b. Judge Brown dissented (App., *infra*, 36a-60a), believing that the majority had "[f]ail[ed] to accord to the [Commission] the expertise which Congress invests in it," "[o]verlook[ed] specific congressional language giving express legislative authority to raise the price of old gas," and "[s]ubstitute[d] its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business." *Id.* at 36a-37a (emphasis omitted). In Judge Brown's view, "Congress could not have been more explicit in authorizing the Commission to raise

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[5] The majority also struck down the requirement in Order No. 451 that a pipeline continue to transport old gas that is released from its contract with the producer and sold to another purchaser. The majority held that as applied to non-open-access pipelines, this requirement imposed impermissible common-carrier obligations on natural gas pipelines. App., *infra*, 32a-35a. We do not seek review of this aspect of the court of appeals' decision because, as the majority below observed (*id.* at 32a n.34; see also S. Rep. No. 38, 101st Cong., 1st Sess. 6 (1989)), most major pipelines are now open-access pipelines, and the ruling below on the mandatory transportation issue therefore is of limited practical importance in the implementation of Order No. 451.

statutory ceiling prices for committed or dedicated gas sales 'if such [higher] price is * * * just and reasonable within the meaning of the [NGA].'" *Id.* at 47a (quoting 15 U.S.C. 3314(b)(2) and 3316(c)). "This means," he continued, "that Congress granted the Commission the express authority to raise the ceiling prices for vintage gas sales," and "[t]he sweeping nature of this legislative grant is reflected by expressly allowing this authority to be exercised 'by rule or order.'" App., *infra*, 47a, 48a. Judge Brown also was of the view that the price ceiling prescribed by the Commission is "just and reasonable" within the meaning of the NGA, since the record "fully supports" the Commission's judgment that "overall and in the long term prices would be lower than otherwise because of the increased supply of relatively lower-priced old gas into the open market competing with the more expensive, incentive-priced and deregulated gas." *Id.* at 50a.

Judge Brown further concluded that the pre-granted abandonment provision of Order No. 451 is lawful (App., *infra*, 52a-55a), because Section 7(b) of the NGA "does not require that the Commission act on such matters only case-by-case." *Id.* at 53a. Finally, he disagreed with the majority on the take-or-pay issue (*id.* at 57a-59a), pointing out that "'reform may take one step at a time'" and that Order No. 451 in any event "provides pipelines with the means to address take-or-pay problems" in negotiations under the GFN procedure. *Id.* at 59a (quoting *Williamson* v. *Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 489 (1955)).

3. On January 15, 1990, this Court granted a stay of the court of appeals' mandate pending the filing and disposition of a petition for a writ of certiorari. No. A-503.

REASONS FOR GRANTING THE PETITION

The court of appeals has set aside a major Order of the Federal Energy Regulatory Commission that was designed to address the substantial regional disparities, production disincentives, and other distortions that have adversely affected natural gas production and distribution. The court has done so by fashioning a regulatory

regime that affords vintage pricing of old gas a special, unalterable status wholly at odds with the flexible "just and reasonable" standard of rate regulation under the Natural Gas Act and the Commission's broad mandate under the Natural Gas Policy Act "to overse[e] a national market price regulatory scheme." *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, 474 U.S. 409, 421 (1986).

The court of appeals' conclusion that the Commission is without authority under Sections 104(b)(2) and 106(c) to increase prices of old gas and eliminate the complex regime of vintage pricing is contrary to the express terms of those Sections, which permit the Commission to set higher price ceilings if they are "just and reasonable" within the meaning of the NGA. In addition, the decision is contrary to the background and purposes of Congress's incorporation of the "just and reasonable" standard into the NGPA for the regulation of old gas; is at odds with this Court's view of the Commission's authority in *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983); and disregards the obligation of a reviewing court under *Chevron U.S.A. Inc.* v. *NRDC, Inc.*, 467 U.S. 837 (1984), to defer to an agency's reasonable construction of the Act it is charged with administering.

The court of appeals also erred in two other respects. First, in striking down the pre-granted abandonment procedure in Order No. 451, the court once again disregarded the plain meaning of the relevant statutory provision (Section 7(b) of the NGA) and a court's obligation to defer to the Commission's interpretation of that provision. Its ruling also is inconsistent with this Court's decisions in related contexts and conflicts with *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988). Moreover, in finding Order No. 451 flawed because it did not address the problem of take-or-pay contracts, the court ignored the fact that the Commission is addressing that issue in other proceedings and impermissibly interfered with the Commission's ordering of its own regulatory activities.

If allowed to stand, the decision will cause substantial disruption in the natural gas industry, because it calls into question the validity of at least 1600 contracts renegotiated in light of Order No. 451. The court's invalidation of Order No. 451 also threatens to reintroduce the market distortions and production disincentives that led the Commission to promulgate the Order. The need for review by this Court is further highlighted by the repeal of price controls effective January 1, 1993, by the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, § 2(b), 103 Stat. 158. The legislative history of the 1989 Act shows that the future deregulation of old gas was based on the premise that the Commission's various administrative measures, including the elimination of vintage pricing by Order No. 451, would provide a necessary and orderly transitional regime until decontrol becomes effective. In these circumstances, a substantial restructuring of the natural gas market as it has developed under Order No. 451, which the decision below apparently contemplates, would be particularly unjustified. Review by this Court is therefore warranted.

1. The court of appeals clearly erred in holding that Order No. 451 exceeds the Commission's statutory authority under the NGPA because it does not perpetuate the 15 separate vintages of old gas under the Commission's prior regulations and the separate ceiling price for each category.

a. As this Court explained in *Chevron*, where the meaning of an agency's organic statute is at issue, a court reviewing the agency's interpretation should follow a two-step analysis. "First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." 467 U.S. at 842-843. But if "Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent

or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843. Accord *Sullivan* v. *Everhart*, No. 88-1323 (Feb. 21, 1990), slip op. 5; *K Mart Corp.* v. *Cartier, Inc.*, 486 U.S. 281, 291 (1988).

The court of appeals did not respect those principles in this case. Congress "has directly spoken to the precise question at issue" in Sections 104(b)(2) and 106(c) of the NGPA, which permit the Commission to raise the ceiling price for old gas as long as the higher ceiling is just and reasonable within the meaning of the NGA. But if there is any ambiguity in the NGPA on this question, the Commission's view of its statutory authority is entirely reasonable and should have been sustained under *Chevron*.

a. Here, as in the Court's most recent case arising under the NGPA, "[t]he plain meaning of the statute decides the issue presented." *FERC* v. *Martin Exploration Management Co.*, 486 U.S. 204, 209 (1988). Sections 104(b)(1) and 106(a) of the NGPA carried forward for the time being the maximum lawful prices for old gas that had been established by the Commission prior to the 1978 effective date of the NGPA (plus a monthly inflation factor). But subsections (b)(2) and (c) of those same Sections expressly authorize the Commission to set a higher price ceiling for old gas, as long as it is "just and reasonable within the meaning of the Natural Gas Act." 15 U.S.C. 3314(b)(2), 3316(c). Those requirements are satisfied here. Order No. 451 combines the 15 separate vintages in effect in 1978 into a single category subject to a single price ceiling that is equal to the highest of the 15 separate ceilings that the Commission's regulations previously prescribed for old gas. As a result, the maximum lawful price for all old gas under Order No. 451 is equal to or "higher" than the pre-1978 ceiling (as adjusted for inflation) for each category of old gas. Significantly, moreover, the court of appeals did not overturn the Commission's determination that the new price ceiling for old gas is "just and reasonable" within the meaning of the NGA. Because

the express conditions in Sections 104(b)(2) and 106(c) of the NGPA for increasing the price ceiling for old gas are satisfied, the court below should have sustained the new ceiling established by the Commission.

The majority nevertheless invalidated Order No. 451—and essentially read out of the Act the express authorization to regulate rates under the "just and reasonable" standard—because it believed that the previous vintage-pricing method was too "significant [a] feature of the NGPA's design" to permit Sections 104 and 106 to be read in accordance with their plain meaning. App., *infra*, 22a-23a. The majority even went so far as to belittle the Commission's reliance on the plain meaning rule as "somewhat ingenious." *Id.* at 21a. But contrary to the majority's view, although the rates in effect in 1978 happen to have been based on a vintage-pricing approach for the 15 categories of old gas, nothing in the NGPA suggests that it froze that particular approach (or the price ceilings in effect under it) for all time. Sections 104 and 106 in fact make no mention of vintage-pricing or any other methodology. They simply continued in effect the pre-1978 *rates—i.e.*, the end result of the Commission's application of its prior vintage-pricing methodology (see *Hope Natural Gas*, 320 U.S. at 602), adjusted for inflation—unless and until the Commission established higher rates within the broad range of what is "just and reasonable" under the NGA, as it now has done.

b. The majority below read Sections 104(b)(2) and 106(c) of the NGPA to grant the Commission authority to depart from vintage pricing only to provide "special relief" in particular circumstances, such as when the "existing congressional ceiling prices become confiscatory." App., *infra*, 22a n.24. But the majority did not and could not ground this narrow view of the Commission's authority in the statutory text. Sections 104(b)(2) and 106(c) both provide that the Commission may prescribe a higher maximum lawful ceiling price "applicable to *any* first sale of *any* natural gas" subject

to the old gas provisions. 15 U.S.C. 3314(b)(2), 3316(c) (emphasis added). Congress's use of the word "any" makes clear that the Commission's authority is all-encompassing (subject only to the limitation that the new rate be just and reasonable), and is not merely a safety valve that is applicable only to the rare producer for which a particular ceiling price for old gas might become confiscatory. Compare *United States* v. *Monsanto*, 109 S. Ct. 2657, 2662 (1989); *Public Employees Retirement System* v. *Betts*, 109 S. Ct. 2854, 2864 (1989). Indeed, because the ceiling price applies to gas already dedicated to interstate commerce in 1978 and is adjusted annually for inflation, it is difficult to see how the price could ever become confiscatory. Congress therefore must have had some other purpose in mind for Sections 104(b)(2) and 106(c).

Moreover, as Judge Brown pointed out in dissent, the "sweeping nature" of the legislative grant of ratemaking authority in Sections 104(b)(2) and 106(c) is underscored by the provision for its exercise "by rule or order." App., *infra*, 48a. Because "[e]xercise of this power is not confined to case-by-case rate making," it is "entirely appropriate for it to be used and employed generically." *Ibid.* As Judge Brown also observed (*id.* at 48a n.7), the Fifth Circuit had previously recognized, in a related context, that "the drafters' choice of the words 'rule or order' . . . clearly contemplates the establishment of an industry-wide scheme." *Texas Eastern Transmission Corp.* v. *FERC*, 769 F.2d 1053, 1061 (1985), cert. denied, 476 U.S. 1114 (1986).[6]

c. The court of appeals sought to avoid the unavoidable clarity of the statutory text by relying on statements by several Members of Congress during the floor debates on the NGPA. App., *infra*, 17a-20a & n.22. The court of appeals "read too much into these scattered bits of legislative history." *Pennhurst State School* v. *Halderman*,

[6] The broad nature of the ratemaking authority is further underscored by the provision in Sections 104(b)(2) and 106(c) for the Commission to set a higher price ceiling for any "category" of gas.

451 U.S. 1, 20 (1981). This Court has repeatedly held that "'[a]bsent a clearly expressed legislative intention to the contrary,' the words of the statute are conclusive." *Hallstrom* v. *Tillamook County*, 110 S. Ct. 304, 310 (1989) (quoting *CPSC* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). The majority pointed to nothing in the legislative history of the NGPA remotely approaching a clearly expressed intention contrary to the text of Sections 104(b)(2) and 106(c).

The floor statements upon which the majority relied consist largely of general descriptions of the political compromise embodied in the NGPA and the NGPA's policies of protecting consumers while at the same time offering sufficient incentives for production of additional gas. App., *infra*, 17a-20a. Those statements are fully consistent with the Commission's approach in Order No. 451. The NGPA ultimately protects consumers of old gas not by permanently freezing whatever vintage prices and pricing system happen to have been in effect for old gas in November 1978 (adjusted for inflation), but by carrying forward the "just and reasonable" standard of regulation that previously applied to that gas under the NGA.

Inasmuch as Congress expressly incorporated the "just and reasonable" standard of the NGA into Sections 104(b)(2) and 106(c)(2) of the NGPA, it must be presumed to have intended the Commission to have as much authority to raise price ceilings and depart from the vintage-pricing approach for old gas as it did before enactment of the NGPA. See *Merrill Lynch, Pierce, Fenner & Smith* v. *Curran*, 456 U.S. 353, 378-382 (1982). As we have noted (see pages 2, 4, *supra*), it was firmly established prior to enactment of the NGPA that the "just and reasonable" standard of the NGA did not mandate any particular ratemaking methodology, as long as the end result met statutory and constitutional standards. *Hope Natural Gas*, 320 U.S. at 602-603; *Permian Basin*, 390 U.S. at 775-777. Furthermore, because vintage pricing was not adopted until 1960, when the Commission shifted to the area-based pricing system sustained in *Permian Basin* (see *Mid-Louisiana Gas*, 463

U.S. at 329)—and because the Commission made clear at that time that it expected vintage pricing to be phased out (see *General Statement of Policy*, No. 61-1, 24 F.P.C. 818, 819 (1960))—vintage pricing plainly is not an essential and unalterable element of traditional NGA principles, as the majority below appeared to believe. In fact, as the Court noted in *Mid-Louisiana Gas*, the Commission, even prior to enactment of the NGPA, had "shift[ed] from a pure historical-cost-based to an incentive-price-based approach, and * * * temporarily abandon[ed] the practice of vintaging." 463 U.S. at 330; see page 4, *supra*.[7] Congress therefore could not have intended that the NGPA's incorporation of the "just and reasonable" standard would require the Commission to continue with vintage pricing for old gas, especially if the Commission concluded (as it did in Order No. 451) that the maximum rates yielded by the vintage-pricing approach were no longer "just and reasonable." This Court recognized as much in *Mid-Louisiana Gas*, observing with specific reference to Sections 104 and 106, that "the statute recognizes that the ceiling may be too *low* and authorizes the Commission to raise it whenever traditional NGA principles would dictate a higher price." 463 U.S. at 333.[8]

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[7] Indeed, the Fifth Circuit, in which most of the producer issues regarding vintages were litigated before enactment of the NGPA, had previously recognized that the NGA permitted at least a substantial modification of the vintaging system in various contexts, including the institution of replacement-cost methodology. See, *e.g.*, *Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, cert. dismissed, 439 U.S. 801 (1978); *Shell Oil Co.* v. *FPC*, 491 F.2d 82, 88 (1974). The District of Columbia Circuit, the other court in which these issues were litigated, took the same view in *American Public Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1058 (1977), cert. denied, 435 U.S. 907 (1978).

[8] Furthermore, the background of the NGPA demonstrates a broad consensus regarding the need for price incentives to encourage production and the importance of market-based rates at the wellhead to achieve that purpose. See *Mid-Louisiana Gas*, 463 U.S. at 331-333; *Transco*, 474 U.S. at 422. It therefore would be contrary to the purposes of the NGPA to construe Sections 104(b)(2)

Moreover, as the Commission observed (51 Fed. Reg. 46,765), portions of the legislative history of the NGPA that were not cited by the court below demonstrate that Congress was aware of the broad and flexible authority vested in the Commission under the "just and reasonable" standard incorporated into Sections 104(b)(2) and 106(c) of the NGPA. For example, Senator Abourezk found it "critical to point out that [the NGA] does not require that the price set by the FERC be cost-based, except that, in the absence of full cost justification, the FERC must show the tangible benefits to consumers. This is the 'end result test' established in FPC against Hope Natural Gas Co." 124 Cong. Rec. 30,018 (1978). He also observed that "[n]othing prevents FERC setting the rates at whatever level is necessary actually to elicit new supply" (*ibid.*). Senator Kennedy similarly observed that the Commission had authority under the NGA "to establish prices which will bring forth gas at a 'just and reasonable' price and to vary that price according to conditions." *Id.* at 30,023. Thus, contrary to the view of the court below, the legislative history of the NGPA confirms that the Commission retains the full measure of its authority under the "just and reasonable" standard to revise price ceilings for old gas.

d. Even if we assume, arguendo, that Congress has not spoken directly to the issue whether the Commission may increase the maximum price of old gas and eliminate complex vintage pricing (so long as the end result is just and reasonable), the court of appeals nonetheless erred in failing to defer to the Commission's interpretation. "If the agency regulation is not in conflict with the plain language of the statute, a reviewing court *must*

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and 106(c) to have implicitly divested the Commission of the authority it previously had, under the flexible "just and reasonable" standard, to consider those factors in establishing a ceiling price for old gas.

give deference to the agency's interpretation." *K Mart*, 486 U.S. at 292 (emphasis added). Moreover, where, as here, Congress expressly delegates to an agency the power to prescribe standards, the resulting regulations should not be set aside by a court "simply because it would have interpreted the statute in a different manner." *Batterton* v. *Francis*, 432 U.S. 416, 425 (1977). In that event, the agency's regulations may not be set aside unless they are "manifestly contrary to the statute." *Atkins* v. *Rivera*, 477 U.S. 154, 162 (1986) (quoting *Chevron*, 467 U.S. at 844); see also *Sullivan* v. *Zebley*, No. 88-1377 (Feb. 21, 1990), slip op. 19. The Commission's regulations prescribing new price ceilings for old gas are based on an entirely reasonable construction of Sections 104(b)(2) and 106(c) of the NGPA and thus are not "manifestly contrary to the statute." The court below, however, did not mention these principles of deference, much less explain why they did not require affirmance of the Commission's pricing approach under Order No. 451. See generally App., *infra*, 17a-23a.[9]

2. The court of appeals likewise erred in invalidating the provisions of Order No. 451 that permit a producer to abandon service under an existing contract if the producer does not reach agreement with the purchaser on a new price under the GFN procedure. In the majority's view, the Commission had no authority under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to grant prior ap-

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[9] The majority's failure to give effect to the plain meaning of the statutory language—or at least to defer to the Commission's expertise—appears to have been prompted by its concern that by increasing the price of old gas, the Commission has essentially achieved "de facto deregulation of old gas" (App., *infra*, 17a). That concern is unjustified. Order No. 451 imposes a ceiling on the price of old gas that is lower than the ceiling for new gas, and it ensures that old gas "is priced at the *lower* of the market or the ceiling price" (51 Fed. Reg. 22,204 (emphasis added)). There is nothing in the statutory framework of the NGA or NGPA that requires the ceiling price to be set below the market price. Compare *Martin Exploration*, 486 U.S. at 209 (market price for deregulated gas below statutorily prescribed ceiling).

proval of abandonments in this manner. App., *infra*, 24a-28a.

Section 7(b) provides that "[no] natural gas company shall abandon * * * any service * * * without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission * * * that the present or future public convenience or necessity permit such abandonment." In Order No. 451, the Commission *did* give its "permission and approval" for abandonment, upon the occurrence of the specified conditions (failure to reach agreement under the GFN procedure and a contract to sell gas to another purchaser), and it did so based on a finding that the public convenience and necessity permitted that result (in order to make available to a willing purchaser the gas that the prior purchaser was unwilling to buy at a higher price). The express requirements of Section 7(b) have therefore been satisfied.

The majority believed that *United Gas Pipeline Co.* v. *McCombs* suggested a contrary result. Not so. In *McCombs*, the Commission had not authorized the abandonment under 7(b), and the court of appeals held that "strict compliance" with that requirement was not necessary. 442 U.S. at 535 (quoting 570 F.2d at 1381). This Court reversed, holding that "Congress could not have been more explicit in establishing Commission approval as a prerequisite for lawful abandonment of service within its jurisdiction." 442 U.S. at 535-536. That prerequisite was satisfied here. *McCombs* does not suggest that Section 7(b) bars the Commission from giving its approval in advance, and the Court in fact held otherwise in *FPC* v. *Moss*, 424 U.S. 494 (1976). There, the Court held that the Commission, upon a proper finding of public convenience and necessity, may simultaneously authorize both the sale of natural gas by a producer in interstate commerce and the abandonment of the sale at a future date.

The court of appeals also cited the phrase "after due hearing" in Section 7(b). App., *infra*, 26a. However, a hearing is "due" on the question of abandonment only if

there are disputed facts that bear on the appropriateness of abandonment under governing standards—here, the standards prescribed by Order No. 451. Legislative-type facts and questions of policy may be resolved by rulemaking, as was done by the Commission in this case. *FPC* v. *Texaco, Inc.*, 377 U.S. 33, 41-44 (1964); *Heckler* v. *Campbell*, 461 U.S. 458, 467 (1983); *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986). If there was any ambiguity on this question, the court of appeals, under *Chevron*, should have deferred to the Commission's reasonable interpretation of Section 7. But once again, the court did not even mention that principle. As the court of appeals acknowledged (App., *infra*, 26a), the District of Columbia Circuit has made clear that Section 7(b) permits the Commission to specify by rule the circumstances that "automatically trigger its approval of abandonment" (*Associated Gas Distributors*, 824 F.2d at 1015 n.17). See also *Kansas Power & Light*, 851 F.2d at 1484 ("the Commission need not hold an evidentiary hearing when no issue of material fact is in dispute"); *Consolidated Edison Co.* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987). This circuit conflict warrants resolution.

3. Finally, the court of appeals' treatment of the take-or-pay issue was erroneous. This Court has made clear that an agency has exceedingly broad discretion to determine the proper ordering of its regulatory priorities and to select the appropriate vehicle in which such priorities will be addressed. *Vermont Yankee Nuclear Power Corp.* v. *NRDC, Inc.*, 435 U.S. 519, 543-545 (1978); see also *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 49-52 (1968) (allowing resolution of take-or-pay issue in other proceedings); *Wisconsin Gas Co.* v. *FERC*, 770 F.2d at 1159-1160. The majority, however, did not even address the scope of an agency's discretion in this regard. Rather, it imposed what the dissent termed an "audacious" requirement (App., *infra*, 58a) that the Commission solve the take-or-pay problem in conjunction with its efforts, through Order No. 451, to eliminate the particular market distortions created by the vintage pricing of old gas. This

rigid ruling is not only erroneous in itself. It also fails to take account of the fact that the Commission has addressed the take-or-pay issue in separate proceedings.[10]

4. As we have explained, the court of appeals' decision disregards the express provisions of the NGA and NGPA; it ignores the principle of deference to the agency's interpretation of the statute it administers, as required by *Chevron;* it is contrary to this Court's view in *Mid-Louisiana Gas* of the Commission's authority to raise the price ceiling for old gas; and it conflicts with other decisions regarding the scope of the Commission's abandonment authority and the discretion of an agency to address regulatory issues in separate rulemaking proceedings. For these reasons alone, the decision below warrants review.

In addition, the decision is of broad practical significance for the production and distribution of natural gas in the United States. We have been informed by the Commission that more than 1600 contracts were negotiated or renegotiated pursuant to or in light of Order No. 451 or were entered into by producers in reliance on the pre-granted authority under that Order to abandon prior contracts if they could not reach an agreement under the GFN procedure and had entered into a new contract with another buyer. If the decision below is permitted to stand, it will call into question the validity of those

[10] The Commission has dealt with the issue of take-or-pay contracts on remand in the Order No. 436 rulemaking proceeding. See Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 50 Fed. Reg. 42,408 (1985), FERC Stats. & Regs., Preambles 1982-1985 (CCH) ¶ 30,665 (1985), aff'd in part and remanded in part *sub nom. Associated Gas Distributors* v. *FERC, supra.* The Commission subsequently repromulgated Order No. 436, with certain revisions, as Order No. 500, 52 Fed. Reg. 30,334 (1987), FERC Stats. & Regs. (CCH) ¶ 30,761 (1987), remanded *sub nom. American Gas Ass'n* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989). The Commission has now issued a final rule on the issue. See Order No. 500-H, 54 Fed. Reg. 52,344 (1989), FERC Stats. & Regs. (CCH) ¶ 30,867 (1989) and Order No. 500-I, No. RM-87-34-058 (Feb. 12, 1990), petition for review pending, *sub nom. American Farm Ass'n* v. *FERC*, No. 87-1588 (D.C. Cir.).

contracts. It also will impair the Commission's performance of its continuing responsibility to resolve take-or-pay disputes, since many settlements of such disputes are dependent on the validity of Order No. 451. Finally, the decision below would lead to widespread litigation in state courts as purchasers seek to rescind or reform renegotiated contracts or reinstate abandoned ones, and to the filing of numerous petitions with the Commission for refunds or other relief. Such proceedings would consume valuable judicial and administrative resources and create considerable uncertainty, thereby threatening to disrupt operation of the natural gas market.

Other consequences would follow if the Commission and the industry are required to return to a rigid vintage-pricing regime. Order No. 451 was designed to correct substantial distortions ir the natural gas market, to produce incentives for the production of trillions of additional cubic feet of old natural gas, to increase competition by bringing those greater supplies of old gas into the market, to hold down overall costs of both old and new gas as a result, and thereby to decrease demand for foreign oil and gas. The decision below threatens to undermine these salutary purposes and effects of the Order. In light of the substantial reliance interests that have grown up around Order No. 451, review by this Court is warranted to prevent these disruptive consequences.

Congress's enactment of the Natural Gas Wellhead Decontrol Act of 1989 further underscores the need for review. Under Section 2(b) of that Act, Title I of the NGPA will be repealed effective January 1, 1993, and the price of old gas will then be unregulated. 103 Stat. 158. But the decision below, if allowed to stand, will generate widespread uncertainty and disruption during the three-year period before the repeal becomes effective, and the effects of that disruption would continue after 1993. The legislative history of the Decontrol Act shows that Congress contemplated that Order No. 451 would function essentially as a transitional device between the NGPA and decontrol. H.R. Rep. No. 29, 101st Cong., 1st

Sess. 6 (1989); S. Rep. No. 39, 101st Cong., 1st Sess. 5-6 (1989). In particular, Congress recognized that "[c]hanges in the natural gas industry and in the framework for Federal natural gas regulation that have occurred over the past decade * * * make the repeal of remaining wellhead controls appropriate." S. Rep. No. 39, *supra*, at 5. Among the Commission actions cited by Congress in this regard was Order No. 451. *Ibid.*[11]

Indeed, Congress recognized that "[t]hrough [Commission] initiatives, more competition in the interstate pipeline industry has brought lower prices to all consumers, including captive residential consumers," and it premised the future decontrol of natural gas on its disapproval of many of the same market conditions and other factors the Commission sought to address in promulgating Order No. 451. H.R. Rep. No. 29, *supra*, at 3-4, 5-7; S. Rep. 39, *supra*, at 3-6. Congress further recognized that as a result of the Commission's initiatives, "[w]hile about one-third of our supplies are still controlled, most of those controls are well above market levels," and only about 5% of the nation's total gas supply was still subject to price controls at below-market levels. H.R. Rep. No. 29, *supra*, at 3-4; S. Rep. No. 39, *supra*, at 3; see also S. Rep. No. 38, 101st Cong., 1st Sess. 3-6 (1989).

The decision below thus repudiates several important premises on which Congress acted in 1989 and threatens to disrupt the orderly transition to a regime of decontrol that Congress intended. Moreover, if the decision below requires reformation of prior contracts that were renegotiated pursuant to or in light of Order No. 451, or the rescission of new contracts entered into as a consequence of that Order, Congress's purposes in enacting the decontrol statute would be frustrated because reinstated contracts might lock in prices at levels substantially below the market rates Congress sought to achieve. Now that the natural gas market is functioning in the more rational and stable manner that Congress found to be a

[11] The Senate Reports note (at 6) that judicial review of Order No. 451 was then pending.

prerequisite to the sound institution of a public policy of full decontrol, the Court should not leave unreviewed an appellate decision that would require the Commission and the industry and market to return to the anachronistic and disruptive regulatory regime of vintage pricing based on historical costs.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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MARCH 1990

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 86-4940

MOBIL OIL EXPLORATION AND
PRODUCING SOUTHEAST, INC., ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT

Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Sept. 15, 1989

Dissenting Opinion Sept. 26, 1989

Before CLARK, Chief Judge, BROWN, and JOHNSON, Circuit Judges.

JOHNSON, Circuit Judge: *

Petitioners, joint opponents of the Federal Energy Regulatory Commission's Order Nos. 451 and 451-A,

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* Judge Brown reserves the right to file a further concurring or dissenting opinion pursuant to Court Policy 15(J).

seek review by this Court contending that the Commission exceeded the scope of its authority in promulgating those Orders. For the reasons cited herein, we agree and vacate the orders complained of.

I. AN HISTORICAL PERSPECTIVE

The instant controversy finds its genesis in the enactment of the Natural Gas Act of 1938 (NGA),[1] which was Congress' first attempt to provide a workable system of natural gas regulation. Congress, aware of the regulatory gap precipitated by a lack of state power to control interstate pipelines, undertook efforts to bridge that gap through the enactment of the NGA. The regulatory policies of the NGA, which were basically designed to deal with what was considered the burgeoning monopoly power of the pipelines,[2] had significant effects on the future regulation of the nation's natural gas industry.

The provisions of the NGA called for cost based price ceilings for the "sale in interstate commerce of natural gas for resale."[3] Section 4(a) of the NGA[4] provided that the standard for first sale natural gas pricing would be a "just and reasonable" rate calculated in accordance with traditional public utility

[1] Pub. L. No. 75-688, 52 Stat. 821 (codified in 15 U.S.C. §§ 717-717w (1976)).

[2] For a series of Federal Trade Commission Reports documenting the alleged abuses by natural gas companies, including monopoly control over consumer prices, *see* Federal Trade Comm'n, Utility Corporations, S. Doc. No. 92, 70th Cong., 1st Sess. *See also* S. Res. 83, 70th Cong., 1st Sess., 69 Cong. Rec. 3054.

[3] NGA § 1(b), 15 U.S.C. § 717(b) (1976).

[4] 15 U.S.C. § 717c(a) (1976).

method principles. The public utility pricing methodology, which allowed pipelines to recover only their actual costs plus a reasonable rate of return and depreciation, was a consumer oriented approach designed to preclude the possibility of pipeline windfalls. In essence, Congress had, through the pricing provisions of the NGA, chosen consumer protection as the overriding objective in the implementation of the nation's first natural gas regulatory scheme. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610, 64 S.Ct. 281, 291, 88 L.Ed. 333 (1944) ("The primary aim of [the NGA] was to protect consumers against exploitation at the hands of natural gas companies.").

The Federal Power Commission (the "Commission")[5] was authorized to administer the NGA's provisions. While the Commission initially construed the provisions of the NGA to regulate gas sales at the downstream end of interstate pipelines,[6] the Supreme

[5] Throughout this opinion, the term "Commission" will refer to the Federal Power Commission and its successor, the Federal Energy Regulatory Commission.

[6] The Supreme Court, in *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983), explained that the NGA

> authorized rates that were "just and reasonable" within the meaning of [the NGA] by examining whatever costs the pipeline had incurred in acquiring and transporting the gas to the consumer. If the pipeline itself or a pipeline affiliate had produced the gas, the actual expenses historically associated with production and gathering were included in the rate base to the extent proper and reasonable. However, if the pipeline had purchased the gas from an independent producer, *the Commission did not take jurisdiction over the producer to evaluate the reasonableness of its rates; it only considered the broad issue of whether, from the pipelines' perspective, the*

Court, in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954); directed the Commission to regulate pricing upstream at the wellhead. In so doing, the Supreme Court interpreted the NGA as "[giving] the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." *Id.* at 682, 74 S.Ct. at 799 (footnote omitted) (emphasis supplied).

Responding to the Supreme Court's directive in *Phillips*, the Commission began regulating rates for individual producers in accordance with the NGA's just and reasonable standards through the application of traditional public utility rate setting principles. Because the Commission initially undertook this task by calculating producer rates on an individualized basis, the Commission soon became unable to keep up with its workload.[7] Accordingly, the Commission shifted from its individualized rate setting scheme to an area rate regulation system whereby producer rates were calculated on the basis of a particular region's average production costs, average investment costs, and average rates of return. *See* Statement of General Policy 61-1, 24 F.P.C. 818 (1960). While the Commission's new regional system preserved the earlier method of calculating prices on the basis of

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purchase price was "collusive or otherwise improperly excessive."

Id. at 328, 103 S.Ct. at 3030 (citations omitted) (emphasis supplied).

[7] The Commission estimated that it would be unable to finish its 1960 workload until 2043. *See* Statement of General Policy 61-1, 24 F.P.C. 818 (1960).

historical costs rather than projected costs, it established a two-tiered rate structure for each area regulated. The area rates, one for "old gas" and one for "new gas" were governed by a Commission set control date. Wells drilled after the control date were priced at a "new gas" rate and wells drilled before the control date were priced at an "old gas" rate. The new pricing system, known as "vintage pricing" or "vintaging" [8] was based on the theoretical assumption that for gas that was already flowing, "price could not serve as an incentive, and since any price above average historical costs, plus an appropriate return, would merely confer windfalls." *Permian Basin Area Rate Cases*, 390 U.S. 747, 797, 88 S.Ct. 1344, 1375, 20 L.Ed.2d 312 (1968). The Supreme Court, in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968) affirmed the Commission's area rate system concluding that not only did the Commission's new regional system yield reasonable prices, but that the Commission's prior individualized approach had become unworkable. *Id.* at 777, 88 S.Ct. at 1365.

With the implementation of the two-tiered vintage pricing system, the Commission hoped that its higher "new gas" prices would stimulate the development of

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[8] Under vintaging, natural gas is priced with reference to the date of the sales contract, or as has been the case lately, the date when the gas was first produced. The rate for older vintages is lower than the rate for later vintages. Logically, the difference is explained by the fact that production and development costs were lower when the earlier gas was discovered. The purpose of vintaging is to provide producers with a reasonable, but not excessive, return on their sunk investment. *See, e.g.*, Opinion No. 770, "National Rates for Jurisdictional Sales of Natural Gas," 56 F.P.C. 509, 521 (1976).

new gas rserves while at the same time ensuring continued consumer protection through lower "old gas" prices. Significantly, however, the Commission was empowered only to regulate the wellhead price of natural gas to be sold for resale in the *interstate* market. Rates on the *intrastate* market on the other hand remained largely uncontrolled. The result of interstate only regulation was that prices for gas sold on the interstate market were kept relatively low while prices for gas sold on the intrastate market continually rose as demand rose. Natural gas shortages increased as a result of sharp pipeline delivery curtailments on the lower priced interstate market.

In an effort to relieve the disturbing shortages, the Commission abandoned the area rate pricing system in favor of a national rate pricing approach. *See Southern Louisiana Area Rate Proceeding*, 46 F.P.C. 86, 110-111 (1971); *National Rates for Natural Gas*, 51 F.P.C. 2212 (1974) (Opinion No. 699). The new national rate approach applied to gas produced from all wells that were drilled after January 1, 1973, and applied across the board to independent producers, pipelines and pipeline affiliates. Additionally, the Commission, in order to ameliorate production shortages, abandoned its prior pure historical cost based approach in favor of an incentive price approach in order to stimulate development of new reserves. *National Rates for Natural Gas*, 52 F.P.C. 1604, 1615-18 (1974) (Opinion No. 699-H) Concurrently, the Commission abandoned, at least temporarily, vintage pricing.

Albeit well intentioned, the Commission's efforts to correct shortages on the interstate natural gas market were inadequate. Recognizing the need to take action, and after some nineteen months of heated de-

bate between the members of Congress who favored deregulation and those who did not,[9] Congress enacted the Natural Gas Policy Act (NGPA).[10] In the NGPA, Congress gave the Commission power to do what the Commission had been unable to do before—regulate wellhead prices in the intrastate market. As a compromise measure, the NGPA contemplated the eventual deregulation of certain categories of natural gas, provided for the gradual price increase of all categories of natural gas, and authorized Commission regulation of natural gas transportation between interstate and intrastate markets.[11]

The NGPA established a pricing system which was based, in part, on the genre of the gas to be regulated, namely, "old gas," "new gas," and "high cost gas."

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[9] Attempts by those who favored deregulation to enact laws which effect deregulation were numerous, but unsuccessful. The most serious attempt was made during the 84th Congress when both Houses passed H.R. 6645, which would deregulate wellhead prices. 101 Cong. Rec. 11930 (1955) (House vote); 102 Cong. Rec. 2096 (1956) (Senate vote). Then President Eisenhower vetoed the bill on grounds totally unrelated to the merits of deregulation. *See* D. Eisenhower, Pub. Papers 256 (1956).

[10] 92 Stat. 3350, (codified in 15 U.S.C. § 3301 *et seq.* (1982)). *See Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 420, 106 S.Ct. 709, 715, 88 L.Ed.2d 732 (1986). (Although in enacting the NGPA, Congress moved towards a less regulated natural gas market, Congress expanded in some respects federal control.)

[11] The NGPA specified the maximum lawful price which could be charged for "first sales" of gas produced in each of eight enumerated categories of gas. The NGPA also prescribed rules for raising prices each month on "first sale" gas and for passing those price increases down to ultimate purchasers.

More specifically, the NGPA set price ceilings on gas depending on when or how the gas was produced. Newer, harder to produce gas commanded higher price ceilings while older gas already under production was pegged with lower price ceilings. Congress had, through the pricing provisions of the NGPA, sought to balance the interests of the consumer by keeping old gas prices low while at the same time encouraging the development of new reserves through incentive pricing.[12]

Recognizing that for certain categories of gas, the new NGPA price ceilings might be set too low, Congress provided an escape valve for the Commission. NGPA sections 104, 106 and 109 authorized the Commission to raise prices in accordance with traditional NGA "just and reasonable" principles for three particular categories of gas. Similarly, section 110(a)(2) appeared to give the Commission the authority to raise price ceilings for the other five categories of gas enumerated in the NGPA. Congress, however, declined to give the Commission the authority to mandate lower price ceilings than those provided for by the NGPA.

The effects of the NGPA were bittersweet. Clearly, the NGPA's regulatory scheme ameliorated, if not eliminated, the disparity between the interstate and

[12] This Court has previously recognized this delicate balance of interests struck by Congress. In *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), we noted that the NGPA "adopted an incentive-based approach to rate-setting for gas production, providing substantially higher prices for 'new' gas than was currently available. At the same time, the NGPA provided consumer protection by maintaining lower prices on flowing gas, providing only limited future price deregulation in 1985, and extending price controls to intrastate sales of gas." *Id.* at 367 (footnotes omitted).

intrastate natural gas markets which existed prior to the passage of the Act. Also, the increased prices provided by the NGPA stimulated increased production of natural gas by providing producers with the incentive to develop additional natural gas supplies. Accordingly, natural gas shortages were alleviated. On the down side, the NGPA's new pricing system created market distortions because it priced categories of natural gas at various levels. Additionally, during the gas shortages of the 1970s and early 1980s, many pipelines entered into take or pay contracts which commanded high prices for large volumes of gas. Later, after the NGPA's provisions had effectively cured earlier shortages, gas became more plentiful and prices became lower. Producers nevertheless continued seeking higher than market prices for gas covered by earlier executed take or pay contracts. As one consequence of higher prices, pipelines had difficulty selling gas.[13] An oversupply resulted along with the inevitable negative economic consequences flowing therefrom. Producers curtailed exploration and development of new reserves. Pipelines were burdened with substantial take or pay obligations. In sum, as a result of all of these circumstances brought on by the implementation of the NGPA, the natural gas market became fraught with distortions.

In an initial attempt to correct these market distortions, the Commission issued a Notice of Inquiry wherein the Commission proposed to increase old gas prices. Notice of Inquiry, *Impact of the NGPA on Current and Projected Natural Gas Markets*, IV

[13] Other factors also contributed to this circumstance. Among them were warmer temperatures and an economic recession.

F.E.R.C. Stats. & Regs. ¶ 35,512 at 35,560, 47 Fed. Reg. 19,157 (1982). Specifically, the Commission's attempt in that regard was ultimately abandoned because of congressional opposition. *See* S. Res. 331, 97th Cong., 2d Sess. (1982). Some three years later on November 18, 1985, the Secretary of Energy (the "Secretary"), pursuant to Section 403 of the Department of Energy Organization Act,[14] tendered to the Commission a notice of proposed rulemaking which, in turn, ultimately prompted the Commission's promulgation of Order No. 451. The Secretary, in his proposal, advanced the argument that the Commission's existing pricing scheme for old gas inhibited the production of vast reserves of old gas, encouraged the importation of oil and gas, and promoted higher prices to consumers. Significantly, the Secretary admitted that while legislative decontrol of gas prices would be the optimal solution for the problems caused by the old gas pricing structure, until such time as Congress did institute deregulation of old gas, the initiatives which eventually were embodied in Order No. 451 would provide an interim solution.

After notice and comment rulemaking and a two day public conference, the Commission issued Order No. 451 on June 6, 1986. The Commission, in Order No. 451, had adopted the Secretary's proposal with some modifications. In Order No. 451, the Commission collapsed the vintaging system which had prevailed under the NGPA and applied a replacement cost methodology to set an above market, purportedly "just and reasonable" price ceiling applicable to all categories of old gas. Thus, the Commission had es-

[14] 42 U.S.C. § 7173 *et seq.*

sentially achived de facto deregulation of old gas.[15] First sellers of section 104 and section 106(a) gas were now able to charge up to the maximum lawful price, if the price were allowable under a contract entered itno after July 18, 1986. Additionally, the Commission determined in Order No. 451 that the contractual authority for the increased sales prices of section 104 and section 106(a) gas was to be found in indefinite price escalator clauses present in existing contracts. The Commission, while acknowledging that the new price ceiling exceeded existing market prices, contended that market forces would reduce the actual price paid for old gas to levels consistent with the NGA's consumer protection mandate. Further, the Commission concluded that sections 104(b)(2) and 106(c) of the NGPA gave the Commission sweeping authority to raise old gas prices, and that there was no requirement that the Commission find the present gas prices unreasonable before raising them.[16]

[15] The Commission's new price ceiling greatly exceeded the competitive market price that exised in June 1986, and continues to exceed the competitive market price today. Thus, de facto deregulation of old gas appears to have been the Commission's real goal, and that circumstance is best illustrated by the Commission's decision to base the "old gas" ceiling price on a replacement cost methodology that "[*b*]*est reflect*[*ed*] *the level at which prices would be established if deregulation of old gas were to occur.*" Order No. 451 at 95 (emphasis supplied). Moreover, the Commission concedes that it has never before applied a replacement cost methodology to flowing (old) gas.

[16] Section 104(b)(2) and 106(c) of the NGPA are virtually identical and provide that

> . . . The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as deter-

Nevertheless, in Order No. 451, the Commission specifically found that the existing pricing scheme with respect to old gas was, in fact, unjust and unreasonable because it contributed to serious market distortions and thwarted gas reserve replacement.[17]

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mined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. §§ 3314(b)(2); *see also* 3316(c) (1982).

The above mention of the Natural Gas Act's "just and reasonable" language refers to the following provisions contained in section 4(a) of that Act:

All rates and charges made, demanded, or received by any natural gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

15 U.S.C. § 717c(a) (1982).

[17] The Commission was driven, in part, by the explicit expectation that the provisions of Order No. 451 would stimulate increased production. In that regard,

[T]he Commission found most persuasive studies showing that if current old gas prices were held at their present levels, approximately 11 Tcf of old gas reserves would not be produced. The 11 Tcf of old gas reserves not produced as a result of vintaging would have been replaced by higher-priced energy supplies. In part, these incremental supply requirements would be met by foreign imports of both oil and gas and nation's energy security would thereby be compromised and its trade balance weakened. Regardless of the source of the incremental supplies, however, the nation's energy users would be

In Order No. 451, and its successor, Order No. 451-A,[18] the Commission prohibited the automatic collection of the new higher ceiling price for old gas explicitly acknowledging that the new ceiling would yield unjust and unreasonable prices. Order No. 451-A at 128. To prevent such a result, the Commission provided for a good faith negotiation (GFN) procedure governing price increases.

The GFN process, which can only be initiated by a producer, consists of three steps. Step One allows a producer to request a pipeline to nominate the price at which the pipeline would be willing to continue

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required to pay more for these incremental supplies than would be necessary.

Order No. 451-A at 18. Other benefits were also expected by the Commission as a result of Order No. 451:

Producers with old gas reserves will obtain additional revenue for exploration and development of gas reserves. Customers will benefit from increased competition and may pay lower gas prices, free from regional disparities, as they gain access to alternative sources of supply and transportation through Order Nos. 451 and 436. The competitive pressures of a wide-open market may also benefit pipelines with increased throughput and the settlement of take-or-pay disputes with producers in exchange for the pipelines' agreement to pay higher old gas prices. Producers may also be persuaded to renegotiate high-cost gas contracts as old gas prices rise, in order to take advantage of increased marketing opportunities for their gas.

Shoneman & McConnell, FERC Order No. 451: Freedom (Almost) for Old Gas, 7 Energy L.J. 299, 324 (1986).

[18] Order No. 451-A clarified Order No. 451. For a discussion of those clarifications, *see* Mogel and Mann, Natural Gas: Current Federal and State Developments 16-20 (1987).

buying old gas under any existing contract.[19] Step Two requires the pipeline to nominate the maximum price up to the ceiling price it would be willing to pay for the old gas *if it wishes to maintain the contract.* During Step Two, the pipeline also has the prerogative to request the producer to nominate a price at which the producer would be willing to continue sales of *any* gas (old or new) under *any other* existing multi-vintage contracts. Finally in Step Three, the producer has the prerogative to nominate a price for gas covered by the pipeline's Step Two request. During Step Three, the producer then may also request that the pipeline nominate a price for any old gas included in the multi-vintage contracts designated by the pipeline in Step Two.

As seen above, the producer (in Step One) is vested with the unilateral right to initiate the GFN process.[20] In the event that the pipeline (in Step Two) nominates anything less than the new, above market ceil-

[19] Order No. 451 defines an existing contract to include an expired contract by which gas is being sold pursuant to an obligation imposed by a certificate of public convenience and necessity. The GFN procedure does not apply to contracts entered into after July 18, 1986, nor does it apply if, after that date, the parties renegotiate the sale price or any other sale terms of old gas under an existing contract. The Commission, on rehearing, did, however, allow for parties to agree in writing to preserve their rights under the GFN procedure even though an existing contract for old gas was amended after July 18, 1986.

[20] Although Order No. 451 became effective on July 18, 1986, a producer could not request pipeline nominations until November 1, 1986. Subsequently, that date was moved to December 18, 1986. Finally, as a result of the issuance of Order No. 451-A on December 15, 1986, the date was again postponed until 30 days after Order No. 451-A was published in the Federal Register.

ing price for old gas as provided for in Order No. 451, the producer has an additional alternative: the producer has the unilateral right to terminate the existing sales contract, receive automatic abandonment of the underlying sales obligation, and require the contracting non-open access pipeline to transport the released gas to new purchasers. To exercise its unilateral right to terminate the contract accordingly, the producer must provide the former pipeline purchaser with thirty days notice of contract termination, and must comply with certain requirements governing the subsequent sale of the released gas. In Step Three, if the producer does not nominate a price covered by the pipeline's Step Two request, the pipeline may terminate its purchases of all or part of the gas named in its request.

The joint opponents, petitioners herein, challenged the provisions of Order No. 451 through rulemaking comments and rehearing requests. The petitioners contended that the Commission did not have authority to adopt the Secretary's proposal because it 1) effectively deregulated old gas and eliminated vintaging contrary to congressional intent; and 2) used replacement costs as the starting point for the calculation of the new price ceilings on the old gas. The petitioners additionally asserted that current market conditions, specifically the surplus of natural gas, did not justify the need for such severe measures. Additionally, the petitioners objected to the Commission's failure to effectively address the problem of high cost take or pay contracts in its promulgation of Order No. 451. The petitioners complained that unless the Commission made the problem "take or pay" contracts market responsive, a tremendous increase in the old gas price ceiling would exacerbate the already serious problem and would ultimately result in higher con-

sumer prices. Finally, the petitioners assert that the Commission's desire to protect against premature abandonment of certain old gas production and stimulate additional production from certain flowing gas reserves could be achieved through alternative measures and in a far less costly manner.[21]

The Commission rejected the contentions of the petitioners and, on December 15, 1986, the Commission, by a unanimous vote, issued Order No. 451-A denying petitions for rehearing of Order No. 451. Thereafter, petitioners filed for review by this Court of the Commission's Order Nos. 451 and 451-A.

II. DISCUSSION

The petitioners object to the pricing, abandonment, take or pay and transportation components of Order Nos. 451 and 451-A. We will address each objection in turn.

A. *Pricing*

Perhaps the most salient and controversial provision of Order No. 451 is the Commission's new pricing structure for old gas. In establishing this new pricing structure, which, as mentioned previously, collapses the previous vintage system and sets a single higher than market ceiling price on old gas, the Commission relies on the "just and reasonable" standard articulated in sections 104(b)(2) and 106(c) of the NGPA. The petitioners strenuously argue that the Commission's reliance on sections 104(b)(2) and 106(c) as justification for raising ceiling prices on

[21] For example, the petitioners contend that the Commission could have targeted specific old gas reserves rather than raising old gas price ceilings across the board.

old gas is misplaced, and assert that the Commission has ignored congressional intent and exceeded its authority by allowing for de facto deregulation of old gas. We are constrained to agree.

An examination of the legislative history of the NGPA reveals that its passage was the result of some nineteen months of heated Capitol Hill debates on the issue of whether the natural gas industry should be deregulated.[22] As discussed above, the NGPA was

[22] The following are excerpts from the Congressional record which demonstrate the challenges faced by Congress in resolving the differences of its members concerning decontrol of the natural gas industry and the complex problems involved in resolving the deficiencies of the NGA's regulotary devices. 124 Cong. Rec. S15019-20 (daily ed. Sept. 13, 1978) (remarks of Senator McIntyre).

> Mr. President, it is time to resolve the conflict over natural gas pricing policy. . . . During the debate nearly a year ago, I was against the proposal to decontrol the price of natural gas. Instead, I favored a policy that would have provided incentives to the natural gas industry to bring in more gas, yet at the same time protect consumers from unwarranted increases and the inflationary effects of sudden price increases.
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> Clearly, we need a compromise between these two extremes. Clearly, we must establish a Federal policy that protects consumers and at the same time provides assurances and incentives to gas producers. Congress as a whole and the energy conferees have labored for nearly 17 long months to come up with a bill that provides this policy. They have put their collective wisdom into the compromise bill that is now before us.
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> It is apparent to all of us that the compromise is not perfect. Some of its flaws are obvious. For example, both the Senate and House passed so-called incremental pricing provisions to protect residential consumers of gas

Congress' response to natural gas shortages precipitated by the Commission's lack of regulatory authority

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> from being hit with the biggest increases. Somehow, the compromise ended up with an incremental pricing provision that protects residential consumers less than either the Senate or House bill.
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> • • • • •
>
> And if we defeat this compromise, what policy will we put in its place for the long run? Are we to cave in to full decontrol, which would create about as much new supply as this bill, but at substantially higher cost? That is what the gas lobby is hoping for. That is why they are prowling the halls of Congress. And the other opponents of this compromise—the consumers organizations, whom I count as my friends—they want to defeat the compromise in the hope that the Federal bureaucracy will roll back gas prices and will on its own begin regulating the gas that producers are now keeping in their own states.
>
> But this is Congress' job. The time has come for this body to put aside regional differences and partisan bickering. Both sides of the debate in the Congress have fought hard for what each thought was best. We now have before us a gas bill that gives neither side all that it wants. But this compromise does provide certainty; it does provide a unified Federal policy for the first time. It does provide substantial incentives for the production of more domestic natural gas. And at the same time it provides a measure of protection for consumers from sudden and unwarranted price increases.

124 Cong. Rec. S14869 (daily ed. Sept. 11, 1978) (remarks of Senator Jackson).

> We a[re] proposing a policy which concentrates the rewards of higher prices where they are most needed—on the development of new, high cost gas.
>
> • • • • •
>
> We wanted to elicit the maximum supply response at a minimum cost to consumers. . . . [i]t also allowed the

over the intrastate market. The NGPA, as recognized by the Supreme Court in *Public Serv. Comm'n of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. at 331, 103 S.Ct. at 3031, was the result of congressional compromise of two "strong, but divergent" positions with regard to the optimal strategy for stimulating increased production of natural gas without higher consumer prices. As we have previously recognized, the essence of the NGPA compromise was the adoption of "an incentive-based approach to rate-setting for gas production, providing substantially higher prices for 'new' gas than was currently available [while ensuring] consumer protection [through] lower prices on flowing gas, providing only limited future price deregulation in 1985, and extending price

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> conferees to achieve a bill that will encourage production while protecting consumers from applying unnecessarily high prices for gas that they could expect to receive at lower prices under current policies.

124 Cong. Rec. H13242 (daily ed. Oct. 14, 1978) (remarks of Rep. Sharp).

> What we are proposing to do and asking Members to act upon is not a perfect solution.
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> • • • • •
>
> Mr. Speaker, we put the highest incentive where the highest risks are and where the greatest gains might come from. The next highest incentives are where there are new gas supplies and major risks, but we think there are pretty good chances that gas can be found.
>
> We tried to see to it that we were protecting the consumers from paying the highest prices where it was not deserved. We tried to focus those price incentives where they would do the most good.

For additional discussion of the legislative history behind the NGPA, *see* Note, Legislative History of the Natural Gas Policy Act, 59 Texas L. Rev. 101 (1980).

controls to intrastate sales of gas." *Pennzoil v. FERC*, 645 F.2d 360, 367 (5th Cir.1981) (footnotes omitted).

In that regard, we are persuaded that Congress deliberately chose to maintain lower old gas prices in order to "[concentrate] the rewards of higher prices where they are most needed—on the development of new, high cost gas" and to elicit "[t]he maximum supply response at a minimum cost to consumers." 124 Cong. Rec. S.14869 (daily ed., Sept. 11, 1978) (Remarks of Sen. Jackson). Further, remarks made by legislators during the NGPA debates support the conclusion that Congress did not intend for the Commission to abrogate, as Order No. 451 has done, the NGPA prescribed pricing structure. *See, e.g.*, 124 Cong. Rec. 28,884 (1978) (Remarks of Sen. Hart: "[C]onsumers should be protected by regulations which prevent the price of old, inexpensive gas from rising"); 124 Cong. Rec. 28,865 (1978) (Remarks of Sen. Domenici: Elimination of vintaging and deregulation of old gas "not doable" or "ever suggested").

While we do not suggest that the Commission's contentions that the disorder in the natural gas market has resulted, at least in part, from the NGPA's vintage pricing structure which compelled natural gas producers to sell gas at below replacement costs are misguided, we nevertheless are constrained to recognize what we perceive to be a clear congressional intent to preserve the old gas pricing provisions of the NGPA. The Commission contends that in promulgating Order No. 451, it has preserved the intent of Congress to protect consumers from higher prices. The Commission argues that, even though it has raised the price ceiling for old gas greatly in excess of current competitive market levels, market forces will nevertheless eventually act to hold old gas prices down. Further, the Commission reasoned that Order No. 451

would cause more old gas to be brought into the market place and that the increased volume of old gas in the market would bring pressure upon the existing sales of high priced new gas and that, as a competitive matter, new gas prices (or quantity of sales) would be reduced. Consequently, according to the Commission, these circumstances would more than offset the increased prices charged for old gas under Order No. 451's new high ceiling.

The Commission, in glossing over the mandates of the old gas pricing provisions of the NGPA, has attempted to rely on a somewhat ingenious application of the plain meaning rule [23] of statutory construction to implement its own scheme through an expansive reading of its authority under NGPA sections 104(b)(2) and 106(c). On rehearing, the Commission's own words betray its logic:

> [T]he Commission recognizes that section 104(b)(1) of the NGPA was intended to directly incorporate the just and reasonable rates, and thus the cost-based prices according to vintage, in effect at the time of the NGPA's enactment. Further, the Commission agrees that Congress considered this provision for old gas prices to be a significant feature of the NGPA's design, intended to mitigate the effects on consumers of allowing higher prices for new gas. . . . However, . . . the Commission [has not] found any legislative history whatsoever on section 104(b)(2), or virtually identical section 106(c) and 109(b)(2), that raises any doubt about its plain

[23] *See, e.g., FERC v. Martin Exploration Management Co.*, 486 U.S. 204, 108 S.Ct. 1765, 1768, 100 L.Ed.2d 238 (1988) ("The plain meaning of the statute decides the issue presented.") (citation omitted).

> meaning. If Congress had intended old gas prices to be forever subject to the ceilings in effect when the NGPA was enacted, . . . sections 104(b)(2) and 106(c) would not have been included in the NGPA.

Order No. 451-A at 11-12 (footnote omitted). As we view the above language, Congress' intent was, as it has been in the past, to protect the interests of the consumer through the incorporation of a vintaged old gas pricing scheme "*as a significant feature of the NGPA's design.*" *Id.* (emphasis supplied).

We agree with the Commission that Congress did not intend, through enactment of the NGPA, to "render the Commission impotent in effectuating its statutory responsibility to serve the public interest." Respondent's Brief at 33. We are also compelled to observe, however, that Congress likewise did not intend, through enactment of the NGPA, to render the Commission omnipotent. Although sections 104(b)(2) and 106(c) do vest the Commission with the authority to raise the NGPA's ceiling prices in accordance with the "just and reasonable" standards of the NGA, this authority does not translate into unfettered discretion.[24] For the Commission to jettison a "significant

[24] The Commission, in construing §§ 104(b)(2) and 106(c) to authorize the implementation of a new, higher than market ceiling price for old gas and the elimination of the old gas vintaging systems, breaks virgin ground. The Commission has previously construed §§ 104(b)(2) and 106(c) far differently and much more narrowly than it does now. Its prior interpretation of §§ 104(b)(2) and 106(c) was to the effect that those provisions are more appropriately interpreted as special relief measures to be utilized in the event that existing congressional ceiling prices become confiscatory. *See, e.g.*, Order No. 72, "Final Regulations Implementing Section 109 of the Natural Gas Policy Act of 1978," F.E.R.C. Stats. &

feature of the NGPA's design" by abrogating the vintage pricing structure, represents, in our view, an improper exercise by the Commission of its limited authority to raise ceiling prices under NGPA sections 104(b)(2) and 106(c). As such, it is an untenable, albeit arguably meritorious,[25] solution to the problem of market distortion in the natural gas industry. More simply put, the Commission has exceeded the scope of its authority under the NGPA.[26]

Reg. (CCH) ¶ 30,135 at 30,965 (1980). Moreover, this Court in *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), emphasized that FERC has a "narrow[] authority to administer the NGPA and to prescribe higher price ceilings only in certain circumstances." *Id.* at 379 (emphasis omitted) (citations omitted).

We also note that if this Court were to uphold the Commission's new ceilnig price on old gas, the issue could never be revisited except by congressional action. The NGPA does not allow the Commission to lower natural gas ceiling prices.

[25] In *Mid-Louisiana Gas Co. v. FERC*, 664 F.2d 530 (5th Cir. 1981), *vacated on other grounds, Public Serv. Comm'n of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983), this Court remarked that "[t]he Commission's duty is to administer the law Congress passed in light of the purposes for which it was passed. *It is not an agency's prerogative to alter a statutory scheme even if its alteration is as good or better than the congressional one.*" *Id.* at 535 (emphasis supplied). Moreover, the Senate, on Wednesday, June 14, 1989, voted 82-17 in favor of a bill that would lift natural gas price controls on January 1, 1993.

[26] In further support of its contentions, the Commission argues that its new ceiling price is not really an "across the board" increase because the Commission explicitly declined to allow for an *automatic* rate increase. The Commission points to the good faith negotiation process as a fundamental component of Order No. 451 in support of this argument. The

B. *Abandonment*

When Congress enacted the NGPA, it retained, for most "committed or dedicated" natural gas, the abandonment requirements of Section 7(b) of the NGA.[27] Under the Commission's Order No. 451, a producer may, in the event of unsuccessful good faith negotiation, receive automatic abandonment by executing a new sales agreement with a new purchaser and by

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GFN process is, however, itself a source of dispute. During oral argument and on brief, the petitioners urged that the GFN process is unacceptably unilateral in nature, and as such, is unreasonable. The petitioners contend that while ostensibly labeled a negotiating device, the GFN process is more of a mechanism by which a producer can unilaterally rewrite the terms of a sales contract within, of course, prescribed parameters. The petitioners point to the fact that prior to the Commission's issuance of Order No. 451, many parties asked the Commission to allow pipelines as well as producers to initiate the GFN process; the Commission, however, rejected this proposal. Other parties requested authority for greater rights of first refusal for pipeline customers under the GFN process, but the Commission likewise rejected those proposals. In fact, the petitioners contend that every single proposal tendered by the petitioners to make the GFN process a more balanced procedure was denied by the Commission.

[27] Section 7(b) of the NGA reads as follows:

> (b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, *after due hearing*, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

15 U.S.C. § 717f(b) (emphasis supplied).

providing the former pipeline purchaser with at least thirty days notice of contract termination. Thus, the Commission essentially has authorized "pre-granted" abandonment. The controlling regulation, found at 18 C.F.R. § 157.301(b), is captioned "Pregranted abandonment" and provides that "[a]ny first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made."

The petitioners argue that the automatic abandonment procedures promulgated by the Commission amount to a flagrant and unacceptable evasion by the Commission of its regulatory responsibilities under Section 7(b) of the NGA. Further, the petitioners argue that by allowing abandonment determinations to "turn on producer discretion" and by precluding pipeline challenge to producer abandonment and subsequent fact-specific Commission review, the Commission has exceeded its authority under the NGA. The petitioners contend that through the blanket abandonment provisions adopted in Order No. 451, the "Commission withdrew its regulatory presence and allowed abandonment [to turn on] virtually absolute unilateral producer discretion, as guided by economic self-interest." Petitioner's Brief at 41.[28] The Com-

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[28] In the past, the Commission has stated that "Section 7(b) . . . prohibits abandonments through the unilateral decision of particular producers based upon the economic considerations affecting them." *Arkansas Louisiana Gas Co. v. Amarex Inc.*, Opinion No. 798, 58 F.P.C. 1617, 1635 (1977). Yet, it would appear that the pre-authorized abandonment provisions and the GFN procedures promulgated by the Commission which are at issue here, would, for all practical purposes, do just that. For the first time, the Commission has placed abandonment authority in the hands of private parties.

mission, on the other hand, cites *Associated Gas Distributors v. FERC*, 824 F.2d 981, (D.C.Cir. 1987), *cert. denied sub nom. Interstate Natural Gas Assoc. v. FERC*, —— U.S. ——, 108 S.Ct. 1468, 99 L.Ed.2d 698 (1988), for the proposition that there is "no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment. . . ." *Id.* at 1015 n. 17 (citations omitted).

The petitioners point to the "after due hearing" language of section 7(b) as support for their argument that the Commission is obligated by the plain language of the statute to conduct a case specific review regarding abandonment. The Commission on the other hand contends that pre-granted abandonment in the context of Order No. 451 serves the overall public interest by ensuring that old gas is kept flowing to a willing purchaser. Further, the Commission disputes the petitioners' "after due hearing" argument by citing *Kansas Power & Light Co. v. FERC*, 851 F.2d 1479 (D.C.Cir.1988), for the proposition that, even in abandonment cases, "it is well established that the Commission need not hold an evidentiary hearing when no issue of material fact is in dispute." *Id.* at 1483. The Commission argues that the abandonment provisions of Order No. 451 represent Commission policy that the propriety of abandonment is governed by a balancing of the needs of current gas consumers being served by the gas reserves with the benefits that would be conferred on the natural gas market as a whole if these reserves were released from dedication.[20]

[20] The Commission first equated the public interest with the interest of the "market as a whole" in an abandonment context in *Felmont Oil Corp. and Essex Offshore, Inc.*, Opinion No. 245, 33 F.E.R.C. (CCH) ¶ 61,333 (1985), *reh'g. denied*, Opinion No. 245-A, 34 F.E.R.C. (CCH) ¶ 61,296 (1986), *rev'd and remanded on other grounds sub nom. Consolidated Edison of New York v. FERC*, 823 F.2d 630 (D.C. Cir. 1987). As the joint opponents point out, however, the *Felmont* case involved limited term abandonment after a case specific hearing. In *Felmont*, the Commission jettisoned the "comparative needs" test which calls for a comparison of the needs of the existing purchaser of the gas with the needs of the particular purchaser that would obtain the gas in the event of abandonment. In its place the Commission adopted a test which compares the needs of the existing purchaser with the needs of the "market as a whole." Nevertheless, the Commission emphasized that such a shift would not eliminate the need for a factual showing sufficient to justify the proposed abandonment, and that fact-specific consideration of the interests of existing beneficiaries of dedicated services, including mitigation of losses to such beneficiaries, would be preserved.

The pre-grant of abandonment runs contrary to the instruction of the Supreme Court in *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d 54 (1979). In *McCombs*, the Supreme Court reversed a court of appeals' decision which held that, upon depletion of reserves, a producer may abandon sales without obtaining prior Commission approval. The Supreme Court concluded that such abandonment, without prior Commission approval, would, in effect, allow producers to determine when abandonment would be appropriate. This result, the Court reasoned, was inconsistent with congressional intent. The Commission distinguishes the *McCombs* case by noting that in the instant case, prior abandonment approval has, in fact, been granted by the Commission. We are not persuaded, however, that such a distinction is helpful to the Commission's argument. Rather, it appears that the pre-grant of abandonment contemplated by Order No. 451 would, as in the

McCombs case, allow a producer, for all practical purposes, to control abandonment through the largely one sided GFN procedure.

In *Public Serv. Comm'n of the State of New York v. FPC*, 511 F.2d 338 (D.C.Cir.1975), the D.C. Circuit emphasized that "[t]here may be reason for the legislature to enact a deregulation for the natural gas industry, but so long as it prescribes a system of regulation by an agency subject to court review the courts may not abandon their responsibility by acquiescing in a charade or a rubber stamping of non-regulation in agency trappings." (citations omitted). *Id.* at 354. Accordingly, we are constrained to conclude that, in the instant case, the Commission has abdicated its responsibility under Section 7(b) of the NGA by providing for an across the board, pre-authorized abandonment provision. Surely such abandonment procedure, being altogether in the producer's control and which may be implemented only at the behest of the producer, would be used only when such utilization would serve the producer's economic interest. As the Supreme Court noted in *United Gas Pipeline Corp. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d 54 (1979), the absence of provisions for factual inquiry into the circumstances of an abandonment allows for the "abandonment determination [to] rest, as a practical matter, in the producer's control, a result clearly at odds with Congress' purpose to regulate the supply and price of natural gas." *Id.* at 539, 99 S.Ct. at 2467 (citations omitted).[30]

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[30] We note that the Commission's reliance on *Felmont Oil Corp. and Essex Offshore, Inc., supra,* is misplaced. *Felmont* involved limited term abandonments of shut-in gas. Moreover, *Felmont*'s limited term abandonments were granted after a case specific evidentiary hearing. Nor are we persuaded by the Commission's assertions that the right to first refusal granted to a pipeline's firm sales customers protects consumer interests. As the petitioners point out, the Commission, in this assertion, fails to take into account that the right of first refusal has no effect on a pipeline's ability to continue to meet its systemwide obligation to provide adequate supplies of gas at reasonable prices.

C. *Take or Pay*

The take or pay problem was born during the 1970s when critical shortages of natural gas allowed producers to virtually dictate the terms and conditions of contracts for sale of natural gas to pipelines. During those years, the prevailing thought was that natural gas supply shortages would continue for quite some time and pipelines were frequently unable to procure enough gas to meet consumer demand. As a result, pipelines entered into take or pay contracts which typically required the pipeline to take a specified volume of gas from the producer or, in the event the gas was not taken, pay for the specified volume agreed to be taken but not taken. Additionally, take or pay contracts frequently contained automatic price escalation clauses which obligated the pipeline to pay either the highest price allowed by law or the highest price paid in a specific geographic area.

Pipelines today are faced with a market vastly different from the market in the 1970s. Conditions now are such that numerous pipelines simply are unable, in many circumstances, to take the quantity of gas required by existing take or pay contracts. Additionally, the natural gas market of today is characterized by oversupply, substantially lower rates for natural gas, and competition. Accordingly, pipelines with high liability take or pay contracts must pay

prices for natural gas that are substantially in excess of current market prices. The end result is that both interstate and intrastate pipelines are currently burdened with take or pay contracts which potentially threaten their very existence as public utilities. At stake may be the spectre of unacceptable rate increases, of unpredictable price movements and even of the unavailability of gas supply.

The petitioners contend that the Commission effectively ignored take or pay issues in Order No. 451 notwithstanding its obligation to resolve the problem. In Order No. 451, the Commission stated that it "believes that the natural forces of competition will resolve the issues surrounding high cost contracts." Order No. 451 at 76. In further deference to forces outside its ambit of control, the Commission, in Order No. 451, reaffirmed its previous position that "problem contracts are primarily a matter for resolution between the parties involved." (footnote omitted).[31] *Id.* Continuing, the Commission emphasized that "for largely *the same reasons expressed in Order Nos. 436 and affirmed in 436-A*, the Commission . . . has confidence that the free operation of market forces will provide a resolution of this issue." *Id.* at 76-77 (footnotes omitted) (emphasis supplied).

In *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C.Cir.1987), the D.C. Circuit, vacating Order No. 436, rejected the Commission's adoption of the above rationale because it failed to effectively address the take or pay problem. The Court observed

[31] *See* Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Docket No. RM85-1-000, 50 Fed. Reg. 42,408, at 42,462-64 (Oct. 18, 1985); Order No. 436-A, 50 Fed. Reg. 52,217 (Dec. 23, 1985), *vacated by Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987).

that the rationale "reflects questionable legal premises" and fails to meet the requirement of 'reasoned decisionmaking.'" *Id.* at 1023. We agree with the D.C. Circuit and conclude that the Commission's continued inaction on the take or pay problem is regrettable and unwarranted. As the D.C. Circuit remarked, the Commission's failure to take action on the take or pay problem "reflects a pervasive frame of mind of the Commission about a crucial problem in the natural gas industry." *Consolidated Edison*, 823 F.2d at 641-42. It simply cannot and "will not be wished away." *Id.* at 639.

The Commission also takes the position that the provisions of Order No. 451 will serve to facilitate the renegotiation of high cost contracts. In support of that contention, the Commission projects that under Order No. 451, pipelines will be able to offer higher old gas prices in return for reductions in new gas prices, and that contract reformations will thus ensue.[32] We are persuaded, however, by the petitioners' contention that the "producers with the new gas problem contracts and the producers with the old gas contracts differ markedly." Petitioners' Brief at 63 (footnote omitted). More directly, the producers with the least amount of old gas have the largest amount of nonmarket responsive contracts. Additionally, even if a contract provides for the sales of old *and* new gas, the pipeline would probably not get much benefit at the bargaining table since only one-third of all new gas is contained in the multi-vintage contracts that the pipeline can bring to the table.

Most damaging to the Commission's position, however, is the previously discussed one-sided nature of

[32] Order No. 451 at 148.

the GFN process. Surely producers would not initiate the GFN process if by so doing, they ran the risk of giving up more on new gas contracts than they would receive in return for their old gas. As we view the operation of Order No. 451, it would not, as the Commission asserts, alleviate the take or pay problem. Rather, the prospect for exacerbating the take or pay problem runs rampant throughout the provisions of Order No. 451. Accordingly, we conclude that the Commission's inaction on the take or pay problem is based on a rationale which is arbitrary and unsupportable.[33]

D. *Transportation*

We turn now to the last component of Order No. 451 which is challenged by the petitioners—the mandatory transportation of released gas. As mentioned previously, Order No. 451 provides that an existing pipeline purchaser, that is not an open access pipeline,[34] must continue to transport any released gas if 1) the pipeline fails to nominate a price in response to the producer's initial request for such nomination, 2) nominates a price less than the highest price as provided for in the escalation provisions of the sales contract, 3) ceases to purchase gas when the first seller fails to submit a timely price nomination, or 4) ceases to purchase gas after rejecting the price nominated by the first seller. As observed by some

[33] The joint opponents recommended a bilaterally initiated GFN process, expansion of renegotiation rights for problem contracts, and a provision for producer refund of take or pay payments which could no longer be "made up" because of Order No. 451.

[34] On the date this case was orally argued some 19 out of 21 major pipelines were either open access, or had filed for open access status.

commentators, this mandatory transportation provision of Order No. 451 appears, at first glance, to impose a common carrier obligation on pipelines in contravention of the Commission's authority under the NGA. *See e.g.*, Mogel, *Transportation and Marketing of Natural Gas* 175 *et seq* (1985); *see also* Mogel & Gregg, *Appropriateness of Imposing Common Carrier Status on Interstate Natural Gas Pipelines*, 4 Energy L.J. 155 (1983).

The petitioners likewise adopt the position that the mandatory transportation requirements of Order No. 451 amount to nothing more than the imposition of common carrier obligations on natural gas pipelines, and that such obligations are not permitted under the NGA. In support of this position, the petitioners rely heavily on *Florida Power & Light v. FERC*, 660 F.2d 668 (5th Cir.1981), *cert. denied*, 459 U.S. 1156, 103 S.Ct. 800, 74 L.Ed.2d 1003 (1982). In *Florida Power & Light*, the Commission ordered Florida Power and Light Company to file a tariff provision which required the Company to provide transportation to a point beyond that which it had agreed on. While *Florida Power & Light* arose under Sections 205 and 206 of the Federal Power Act, its holding is nevertheless apposite to the facts in the instant case since NGA sections 4 and 5 were patterned after the Federal Power Act and are virtually identical to Sections 205 and 206 of the Federal Power Act. *See United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 346, 76 S.Ct. 373, 381, 100 L.Ed. 373 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353, 76 S.Ct. 368, 371, 100 L.Ed. 388 (1956). In reversing the Commission's imposition of common carrier status in *Florida Power & Light*, this Court found that

> [t]he imposition of common carrier status on FP & L, which the orders at issue accomplish, is precisely the authority which the [Federal Power Act] denies the Commission. The legislative history of the [Federal Power Act] makes clear that the Commission lacks the authority to require electric utilities to provide wheeling even on a reasonable request. Accordingly, we conclude that the Commission lacked statutory authority to issue the orders in question.

Florida Power & Light, 660 F.2d at 676 (footnote omitted).

The legislative history of the NGA, when viewed along side its predecessor, the Federal Power Act, leaves little room for doubt that the Commission has exceeded its authority in implementing the transportation requirements of Order No. 451. As the petitioners note, in the first legislation ever undertaken which affected natural gas pipelines, the Interstate Commerce Act of 1906, Congress expressly exempted transporters of natural gas from the definition of common carrier.[35] Later, in 1914, the House rejected a bill which would have imposed common carrier status on the pipelines.[36] Again, in 1935, Congress rejected a bill which would have required pipelines, among others, to transport gas for any person upon reasonable request.[37] As recently as 1978, Congress,

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[35] Pub. L. No. 59-337, 34 Stat. 584.

[36] S. 3345 63rd Cong., 2d Sess., 50 Cong. Rec. 5847-49 (1913).

[37] H.R. 5423, 74th Cong. 1st Sess. 303, 304 (1935). *See also* Hearings Before the Committee on Interstate and Foreign Commerce, House of Representatives on H.R. 5423, 74th Cong. 1st Sess. 1646 (1935).

in passing the NGPA, specifically precluded the Commission from treating pipelines as common carriers.[38] Even the Commission itself has recognized that the NGA fails to give it the authority to impose common carrier status on pipelines. *See* Order No. 490, "Abandonment of Sales and Purchases of Natural Gas Under Expired, Terminated, or Modified Contracts," III F.E.R.C. Stats. & Regs., Regulations Preambles, (CCH) ¶ 30,797 at 31,036 (1988). ("Pipelines are not common carriers and only have the duty imposed on them by their certificate.") Nevertheless, the Commission here has inexplicably exceeded its authority and essentially made non-open-access pipelines common carriers.

Moreover, the Commission ignored the requirements of the Administrative Procedure Act[39] in promulgating Order No. 451's mandatory transportation requirement. The Commission's notice failed to request comment on its proposed authority, or lack thereof, to impose common carrier status on pipelines. Because the Commission's failure to do so precluded the presentation of relevant evidence essential to reasoned decisionmaking in this case, we must conclude that the Commission has avoided a fundamental responsibility under the Administrative Procedure Act. *See, e.g., Texaco, Inc. v. FPC*, 412 F.2d 740 (3d Cir.1969). Accordingly, and for the reasons mentioned above, we are constrained to conclude that the Commission has exceeded its authority by imposing common carrier status on non-open-access pipelines through the mandatory transportation requirements of Order No. 451.

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[38] *See* NGPA Section 602(b), 15 U.S.C. § 3432(b).

[39] 5 U.S.C. § 551 *et seq.*

III. CONCLUSION

Having relied on the language, purposes and history of natural gas regulation as evidenced by the provisions of the NGA and the NGPA, we are constrained to conclude that the Commission has, in the promulgation of Order Nos. 451 and 451-A, exceeded its authority as conferred by Congress. Further, while we remain poignantly aware that the problems facing the natural gas industry are numerous and complex, we nevertheless emphasize that Congress alone has the power to do—or authorize the Commission to do—what the Commission has done in Order Nos. 451 and 451-A. We must therefore vacate Order Nos. 451 and 451-A in their entirety; it is so ordered.

VACATED.

JOHN R. BROWN, Circuit Judge, dissenting.

Because the Court:

¶ *Looks* upon the question of (i) pricing (ii) good faith negotiation (iii) first refusal (iv) abandonment and (v) mandatory transportation for new customers as separate, individual issues rather than as integrated parts of a comprehensive solution to the problems of the natural gas business

¶ *Fails* to accord to the Federal Energy Regulatory Commission (FERC) the expertise which Congress invests in it for broad ranging operational fact conclusions and policy including replacement costs in lieu of historical costs of service

¶ *Undertakes* to decide on its own, the factual validity (invalidity) of long range predictions of the Commission

¶ *Overlooks* specific congressional language giving express legislative authority to raise the price of old gas

¶ *Presumes* to impose on the Commission responsibilities to consider and, once and for all, to solve the vexing problem of Take-or-Pay

¶ *Disregards* the practical necessities in the Commission's determination to permit abandonment of existing contracts after good faith negotiation

¶ *Disregards*, likewise, the practical necessities of requiring mandatory transportation by "open access" pipelines of gas for new customers after good faith negotiations and right of first refusal to existing customers and in effect

¶ *Substitutes* its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business,

I must respectfully dissent.

A Big Single Package

Following the highest political traditions of this nation, in which the people expect of the President and the Executive Department the initiation of programs and policies affecting matters of great public importance, the action of FERC in the 451 Orders owes much to the Secretary of Energy's December 1985 statement:

> The existing price structure for old gas creates a barrier against the *production of tens of trillions of cubic feet of old gas reserves*, even though these reserves are easier and less expensivee to produce than other gas sources. The artificially low prices imposed on old gas by the existing

price structure prevents us from producing all our economically recoverable old gas supplies. As a result, Americans are consuming gas from more expensive sources, as well as imported oil and gas, instead of *first consuming inexpensive old gas.* America should produce all it's [*sic*] economical gas resources, but it should produce it's [*sic*] least expensive gas first. The Department estimates that greater recovery of domestic old gas resources would provide the U.S. economy with *economic benefits of over $25 billion during the next decade.* The benefits would result from greater economic efficiency, higher domestic gas production and lower payments for gas and oil imports. (Emphasis added).

This precipitated FERC's initiation of extended proceedings on the problems of the natural gas business including gas surplus and reduced demand, but increasing city/gate prices. The Commission held extended hearings and received written comments from all segments of the gas industry. Thereafter, the Commission, exercising its authority under NGPA §§ 104 and 106 [1] to raise ceiling prices "if just and

[1] Section 104(b)(2):

Ceiling prices may be increased if just and reasonable. The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. § 3314(b)(2) (1982); *see also* 15 U.S.C. § 3316(c) (1982).

reasonable within the meaning of the Natural Gas Act," issued the two hundred seventy-four page Order No. 451 (R. 5390-5664).

Sharply abbreviated, Order 451:

Allows producers (first sellers) of old gas to engage in Good Faith Negotiations (GFN) with pipeline purchasers for a higher price up to the newly created ceilings;

allows sellers to terminate existing contracts in the absence of agreement from GFN;

allows existing sellers to terminate and abandon existing contracts where agreement is reached with a new user/purchaser after notice of first refusal.

The result was to collapse the fifteen different "vintage" price categories under NGPA § 104(a) into a single category with the ceiling price pegged to the highest of the vintage rates. Three reasons were expressed. First, valuable supplies of inexpensive old gas were being inadequately developed. The Commission found that raising the ceiling price would have a significant impact allowing "over 11 Tcf [trillion cubic feet] of additional old gas to be recovered." (R. 5414). Second, the Commission determined that vintage prices kept this old gas priced below a competitive market price. The unequal access to low cost old gas resulted in certain consumers and regions obtaining an unfair competitive advantage.[2] Third, in

[2] The Commission found that:

wide variations in pipeline access to old gas have created huge disparities in the prices consumers pay for gas at the burner-tip around the country. For example, in 1984, the average residential price of gas in Washington, D.C. was $8.05 per Mcf, while the average price in

addition to the competitive advantage to some pipelines the rolling-in old gas prices subsidized producers' sales of high-cost gas or price-deregulated gas.

After first determining that since §§ 104(b)(2) and 106(c) expressly authorized the revision of old gas ceiling prices the Commission need not find existing old gas prices unjust and unreasonable in order to change them, the Commission proceeded to find that the existing old gas price structure was unjust and unreasonable because of these distortions and the reserve replacement it engendered. (*See* R. 5460). The Commission then reached this profound conclusion:

> [T]he current problems being experienced in natural gas markets would largely be remedied by collapsing vintages and raising ceiling prices of below-market priced gas.

(R. 5461).

The Replacement Cost Approach

Pursuing its findings that a price increase for "old gas" was necessary, the Commission determined that any ceiling price should, as closely as possible, approximate the replacement cost of that gas.

After explaining that it had previously used replacement costs, *see* Opinion No. 699-H, 52 FPC 1604, 1631 *aff'd; Shell Oil Co. v. FPC*, 520 F.2d 1061, 1076-77 (5th Cir.1975), *cert. denied*, 426 U.S. 941, 96 S.Ct.

Kansas was $4.49 per Mcf. Kansas is served by KN Energy and Northern Natural, whose old gas "cushions" in 1984 amounted to 65 percent and 47 percent of their wellhead purchases, respectively. On the other hand, Washington, D.C. is served by Transcontinental Gas Pipe Line whose 1984 old gas cushion was only 28 percent of its total purchases.

R. 5414-15.

2661, 49 L.Ed.2d 394 (1976); and *see* Opinion No. 770, 56 FPC 509, 521, *aff'd*, *American Public Gas Ass'n. v. FPC*, 567 F.2d 1016, 1033 (D.C.Cir.1977), the Commission concluded:

> It seems clear based on the above-cited judicial precedents that the issues of replacement costs versus historical costs as well as vintage-based versus uniform rates are matters within the Commission's reasonably exercised discretion.
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> • • • • •
>
> The NGPA provides strong economic support for pricing old gas at the long-run marginal cost of gas, which is equivalent to replacement cost.

(R. 5485).

Good Faith Negotiations

For natural gas sold under existing contracts having an indefinite price escalator clause, the Commission created a good faith negotiation (GFN) procedure, 18 CFR § 270.201 (1988), under which the producer/seller, to obtain any rate increase, must first request a renegotiation (nomination) of the existing contract price. The purchaser (usually a pipeline) may then accept or reject those terms or proposed alternative prices. The existing purchaser is not obligated to purchase gas it cannot market. If the producer invokes GFN the pipeline/purchaser can require the producer to renegotiate any contracts covering the sale of both vintage (old) gas and high-cost (new or deregulated) gas. *See* 18 CFR § 270.201 (b)(2) (1988). The Commission in a reasoned way [3]

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[3] *See* Order No. 451, p. 185:

> . . . the Commission agrees . . . that the good faith negotiation rule . . . cou'd be unbalanced. . . . For ex-

found that this provision was necessary to balance the operation of GFN and to provide pipelines/purchasers with a means to reduce high-cost gas purchases. The upshot is that if the producer and pipeline/purchaser are unable to agree on new price terms, old gas and mixed contracts can be terminated by either party. On the other hand, if a new price is otherwise mutually agreed upon the sale must continue at the agreed upon price.

Abandonment and Transportation Provisions

As an essential ingredient of the GFN rule the Commission added two additional provisions to ensure that the old gas continued to reach the market at a fair, negotiated price. First, if a pipeline purchaser fails to respond to the producer's new price nominations and rejects [4] the producer's price to terminate

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ample, if a contract included both old and other gas, the producer could seek a higher price for the old gas but the purchaser could not seek a lower price for other gas. If the producer was not satisfied with the price nominated by the purchaser for the old gas, the producer could terminate sales of the old gas to the purchaser, sell that gas to a third party, but require the purchaser to continue purchasing the other gas. . . .

In order to cure these inequities in the operation of the good faith negotiation rule . . . the Commission will modify the [GFN] rule . . . [to] permit the purchaser to seek a lower price for any gas . . . in any contract between the parties which contains some old gas.

(R. 5580-81).

[4] If the producer rejects the nominated price, the producer would be free to sell all the gas to a new purchaser subject to the right of first refusal on the part of the existing firm customers of the existing purchaser. There would be no required term for the new contract, nor any higher price re-

the gas purchase agreement, "[t]he first seller (producer) is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas" if it has contracted to sell the gas to a new purchaser. 18 CFR §§ 270.201(c)(1), (e)(4) and (f)(5) (1988). Such producer abandonment occurs without further Commission action under § 7(b) of the NGA.[5]

The second provision requires that if there is an abandonment of the sale to the pipeline and a sale by the producer of the released gas to others, the pipeline, if not an "open access" pipeline, must continue to transport that gas. 18 CFR § 270.201(a) (1988).

The Commission found:

> We conclude that this rule [GFN] should establish reasonable procedures by which gas which is released . . . can be transported by pipelines not under Order No. 436. . . . However, without Commission action, there is no assurance that first sellers will be able to market their released gas unless their existing purchasers have accepted the terms and conditions of Order No. 436. We believe it is essential . . . to assure the availability of transportation service irrespective of

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quirement. Once a new purchaser is found, the producer would be released from all obligations in law and contract to the existing purchaser upon 30 days notice. However, in the interim, the producer would be required to continue to sell the gas to the existing purchaser at the existing contract price. R. 5592, Order No. 451.

[5] If the pipeline is not "open access" such pipeline's firm gas customers "would specifically have a 'right of first refusal'." *See* 18 CFR 270.201(g) (1988).

> whether a particular purchaser has or has not accepted the open-access obligations of Order No. 436 . . .

to formulate reasonable and fair transportation provisions (R. 5608-09).

Without access to transportation the GFN process would be insulated from competitive benefits and both producers and pipelines would be restricted in their access to gas supplies released under the rule.

> Under the good faith negotiation procedure, the existing pipeline purchaser may choose or not choose to terminate purchases of gas under an existing contract with a producer. As a condition on the pipeline's exercise of these options, the limited transportation authority is reasonably intended to assure that the pipeline's existing customers, especially firm sales customers, have a practical means of keeping the gas on-system and getting it transported for their use.
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> * * * * *
>
> In most instances, first sellers would be unable to market released gas to alternative purchasers unless the existing purchaser agreed to transport the gas or is an Order No. 436 transporter. The existing purchaser would have little if any incentive to do so, however, because in the absence of transportation the first seller would have little alternative but to continue selling to the existing purchaser at the current price. The result would frustrate the purposes of this rule and force the first seller to accept a price which we have found to deny both consumers and producers the full benefits of competition and long-term reliable gas service under the NGPA and NGA. We therefore

> believe that [GFN] would be ineffective . . . unless combined with a transportation provision designed to encourage purchasers to negotiate in good faith and to provide first sellers with reasonable access to an alternative market in the event no agreement on pricing is reached.

(R. 5610, 5611-12).

> However, newly priced gas must be keyed to the availability of transportation, or the market-responsive benefit of the rule would be lost, and the public interest benefits of the new ceiling prices also lost. It is in this sense that the new ceiling is only just and reasonable in conjunction with the accompanying transportation provision.

(R. 7428).

The Commission also found that while the price of gas might go up from increased old gas prices it would lower prices and increase supply in the long run.

On rehearing the Commission reaffirmed its finding that producer abandonment was in the overall public interest, (R. 7315), and that over the long haul, customers would have better access to supplies of gas if the old gas could get to a willing purchaser. The Commission also reaffirmed its ruling requiring pipelines to continue to provide transportation. (R. 7419).[6]

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[6] In addition to stressing practical necessities and avoidance of frustration of the objectives of GFN the Commission stated:

> By requiring a pipeline to continue to provide transportation for released volumes, the pipeline is prevented from unduly discriminating against the existing seller and harming competition by denying a producer trans-

Pricing

The Court's opinion finds FERC's abandonment of vintaging and establishing the new ceiling prices for old gas is contrary to both NGA and NGPA and beyond the statutory powers of the Commission. Cast in this light, the controversy becomes essentially a rate case "to assure an adequate and reliable supply of gas at reasonable prices." *California v. Southland Royalty Co.*, 436 U.S. 519, 523, 98 S.Ct. 1955, 1957, 56 L.Ed.2d 505 (1977), *citing Sunray Mid-Continent Oil Company v. FPC*, 364 U.S. 137, 147, 151-154, 80 S.Ct. 1392, 1398, 1400-1402, 4 L.Ed.2d 1623 (1960) and *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959). Under the just and reasonable standard, § 5, 15 U.S.C. § 717d, the Commission's approved rate must:

> [R]easonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed and yet provide appropriate protection to the relevant public interests, both existing and foreseeable.

Permian Basin Area Rate Cases, 390 U.S. 747, 792, 88 S.Ct. 1344, 1373, 20 L.Ed.2d 312 (1968).

In setting "just and reasonable" rates the Commission is not "bound to the service of any single regulatory formula," *Permian*, 390 U.S. at 776, 777, 88 S.Ct. at 1364, 1365, and so long as the Commission engages in reasoned decision making under the just

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portation and thereby blocking the benefits of the final rule.

R. 7428.

and reasonable standard ". . . it is the result reached not the method employed which is controlling." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 64 S.Ct. 281, 287, 88 L.Ed. 333 (1944). All that is needed is a reasoned basis by the Commission "to assure itself that the Commission has given reasoned consideration" to the relevant factors. *Permian Basin Area Rate Cases*, 390 U.S. at 792, 88 S.Ct. at 1373.

After enactment of NGPA "[t]he aim of federal regulation remains to assure adequate supplies of natural gas at fair prices." *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 421, 106 S.Ct. 709, 716, 88 L.Ed. 2d 732 (1986).

NGPA Provides Express Authority to Raise Old Gas Prices

By §§ 104 and 106 of the NGPA, Congress could not have been more explicit in authorizing the Commission to raise statutory ceiling prices for committed or dedicated gas sales "if such [higher] price is . . . just and reasonable within the meaning of the Natural Gas Act." §§ 104(b)(2)(B) and 106(c), 15 U.S.C. §§ 3314(b)(2)(B) and 3316(c) (1982), *see* note 1, *supra*. This authority applies to any first sale of *any* natural gas subject to § 104(b)(2), 15 U.S.C. § 3314(b)(2) (1982). This means that Congress granted the Commission the express authority to raise the ceiling prices for vintage gas sales. As the Supreme Court described it, "the statute recognizes that the ceiling may be too *low* and authorizes the Commission to raise it whenever traditional NGA principles would dictate a higher price." *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 333, 103 S.Ct. 3024, 3032, 77 L.Ed.2d 668 (1983) (emphasis in original).

The sweeping nature of this legislative grant is reflected by expressly allowing this authority to be exercised "by rule or order." Exercise of this power is not confined to case-by-case rate making. It is entirely appropriate for it to be used and employed generically.[7] Nor is there any basis for thinking that Congress intended or demanded that vintage pricing be continued in perpetuity. *Subcommittee on Energy and Power*, 95th Cong., 1st Sess., *Economic Analysis of Natural Gas Policy Alternatives* (Comm. Print 31, 1977) ("Both House and Senate versions would eliminate vintaging of new natural gas.").

Whatever the nuances of expressions by individual members of the Congress in the so-called legislative history, the words of Congress are explicit and decisive. They reflect in no uncertain terms that in enacting NGA, Congress did not mean to adopt a self-defeating statutory scheme which would bar the Commission from raising vintage ceilings when to do so was part of a comprehensive effort "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlanta Refining Co. v. Public Services Commission of New York (CATCO)*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959).

Commission's Determinations Just and Reasonable Under NGA

The Commission meets its just and reasonable NGA responsibilities when it sets rates to assure that there

[7] In a related context, *see Texas Eastern Transmission Corp. v. FERC*, 769 F.2d 1053, 1061 (5th Cir. 1985), *cert. denied*, 476 U.S. 1114, 106 S.Ct. 1967, 90 L.Ed.2d 652 (1986) "the drafters' choice of the words 'rule or order' . . . clearly contemplates the establishment of an industry-wide scheme of reimbursement."

is "an adequate and reliable supply of gas at reasonable prices" *California v. Southland Royalty Company*, 436 U.S. 519, 523, 98 S.Ct. 1955, 1975, 56 L.Ed. 2d 505 (1978). The accepted precedents do not require that "just and reasonable" rate making invariably requires rates pegged to recover only historically-based costs.[8] The choice whether to adopt replacement cost pricing "to put some of the burden of replacing scarce gas supplies on the consumers of flowing gas" is the Commission's to make, *Tenneco Oil Co. v. FERC*, 571 F.2d 834, 840 (5th Cir.1978), *cert. dismissed*, 439 U.S. 801, 99 S.Ct. 43, 58 L.Ed.2d 94 (1978), and this Court has affirmed the Commission's choice to do so. *Shell Oil Co. v. FERC*, 520 F.2d 1061 (5th Cir.1975), *cert. denied*, 426 U.S. 941, 96 S.Ct. 2661, 49 L.Ed.2d 394 (1976).

Without implying, as the Court's opinion suggests, that sustaining Order No. 451 would make the Commission *omnipotent* beyond the powers established by Congress, it is clear beyond question that Congress did not by the NGPA intent to render the Commission *impotent* in effectuating its statutory responsibility to serve the public interest. Rather, as the Supreme Court has clearly stated, to achieve the regulatory goal, the Commission must be free "to make the pragmatic adjustments which may be called for by particular circumstances." *Permian Basin*, 390 U.S. at 777, 88 S.Ct. at 1365, *quoting FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942).

Replacement cost pricing does not in any way depart from the NGPA's regulatory scheme. The NGPA

[8] Reliance on *City of Detroit v. FPC*, 230 F.2d 810 (D.C. Cir. 1955) and *Bell Oil Corp. v. FPC*, 255 F.2d 548, 553 (5th Cir.) are misplaced. (See R. 7233-37).

introduced a regime of market-based wellhead pricing. As the Commission explained in considerable detail (R. 5433-5437, 5443-5449, 7207-7112, 7324-7333), providing for renegotiation of old gas sales prices capped by a replacement cost ceiling properly carries out the free market approach reflected in the congressional enactment of the NGPA.

Overall Impact of Commission's Orders Just and Reasonable

The GFN is in no sense an "across-the-board rate increase." Rather, it affords the purchaser the option to pay or not to pay a higher price, to renegotiate some high-cost ("new") gas prices, and to have the opportunity to cancel gas purchase contracts thus paying no increased rates. GFN is a fundamental part of the 451 Orders assuring, in line with the NGPA pricing approach, that prices reflect the market's needs and that the rates are "just and reasonable."

There is no basis for the contention by protestants that increased lower gas prices will result. The Commission's extended explanation, (*see* R. 5529-5568 and 7283-7306), fully supports the Commission's judgmental conclusion that while prices to some consumers might rise in the short term under the new rules, overall and in the long term prices would be lower than otherwise because of the increased supply of relatively lower-priced old gas into the open market competing with the more expensive, incentive-priced and deregulated gas.[9] This is the sort of expert pre-

[9] The Commission found that:

> under [the] "good faith" negotiation rule, old gas would actually be priced at the prevailing market price or the new ceiling price, so the practical effect of the proposed rule is to provide a price for old gas equal to the market price or replacement cost, *whichever is lower.*

R. 5487.

And, as the Commission expressed on rehearing:

> The Commission continues to believe that eliminating vintaging will cause a substantial increase in recoverable reserves of old gas. Furthermore, nothing raised on rehearing causes the Commission to modify its belief that DOE's study predicting an approximately 11 Tcf increase is the most convincing analysis in the record of that increase.

R. 7262.

diction—"[t]hat 'the increased incentive to compete vigorously in the market would eventually lead to lower prices for all consumers' "—which should be given deference by the courts. *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1008 (D.C.Cir. 1987) (citations omitted).

An essential ingredient in this analysis is that wellhead gas is now practically competitive. The Commission affirms:

> The Commission believes, however, that the market for wellhead natural gas sales is workably competitive. In the first place, Congress so found when it enacted the NGPA. Implicit in the removal of the Commission's authority to regulate the price of new gas is a finding that the wellhead market for natural gas is competitive.

(*See* R. 5532).

As this Court stated in *Pennzoil v. FERC*, 645 F.2d 360, 378-79 (5th Cir.1981):

> Contrary to the Supreme Court's assumption in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 [74 S.Ct. 794, 98 L.Ed. 1035] (1954), which subjected gas producers to utility-type regulation under the NGA, Congress apparently

decided that gas producers do not have "natural" monopoly power.

Similiarly, in *Transcontinental Gas Pipeline Corp. v. Shell Oil and Gas Board of Mississippi*, 474 U.S. 409, 421, 106 S.Ct. 709, 716, 88 L.Ed.2d 732 (1986), the Supreme Court stated, "the NGPA reflects a congressional belief that a new system of nautral gas pricing was needed to balance supply and demand . . . [t]he new federal role is to 'oversee a national *market price* regulatory scheme.' " (Emphasis added).

Nor is there any basis for the contention that the Commission "assumed" away the problem of uneconomical contracts or the existence of a present gas market surplus. The Commission in a reasoned way reached the view that the 451 Orders, by increasing the competition for low-cost gas and by providing pipelines, through the GFN, with the power to require producers seeking higher old gas prices to renegotiate high-cost gas sales in mixed contracts, would blunt the force of uneconomic contracts.

Producer Abandonment and Mandatory Transportation: Proper Exercise of Statutory Authority

This is really at the heart of the goals of Order No. 451. As the Commission explains, Order No. 451 would be a meaningless exercise if, despite the Commission's finding that the vintage pricing system was unjust and unreasonable, pipelines with dominant market power could nevertheless effectively nullify GFN and shut in the gas or otherwise prevent increased supplies from reaching the market at a competitive price.[10]

[10] The Commission said:

> As the Commission stated in Order No. 451, abandonment under the good faith negotiation rule is in the public interest, since it is necessary to ensure that the goals of Order No. 451 of increased production of old gas and overall lower prices described . . . are achieved. These goals cannot be achieved unless prodcers can obtain the market-responsive prices permitted by the rule. Without the possibility of abandonment, purchasers under existing contracts could prevent producers from obtaining those prices by insisting on continuation of the present price.

R. 7315.

The GFN does not, as claimed, empower a producer unilaterally to abandon old gas sales. A producer may abandon only if: (1) the GFN process does not work and the pipeline signals its intent not to purchase the gas at a mutually agreed upon price; *and* (2) the producer has contracted to sell the gas to a new purchaser. 18 CFR § 270.201(c)(1); (e)(3) and (4); and (f)(5) (1988).

The rule, circumscribed as it is with protective conditions, reflects the Commission's determination that it is in the overall public interest that the old gas continue to flow to a willing purchaser. (R. 7314-7320).

Nor, as this Court's opinion asserts, does § 7(b) of the NGA condemn this streamlined abandonment procedure so obviously demanded by practical necessities. The language of § 7(b) does not require that the Commission act on such matters only case-by-case. Nor does any such right arise by implication from the "due hearing" requirement of § 7(b). *See Kansas Power and Light Co. v. FERC*, 851 F.2d 1479 D.C.Cir.1988). And, as the D.C. Circuit declared in its monumental *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1015, n. 17 (D.C.Cir.1987), case, there is "no procedural objection to the Commission's identification of circumstances . . . which automatically trigger its approval of abandonment" since the law

has long recognized that the Commission may act generically when the situation warrants. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. at 774-777, 88 S.Ct. at 1365.[11]

The public interest is clearly served by these hedged-in conditions. First, the Commission found "generally a purchaser's loss of gas under abandonment provisions of the good faith negotiations rule should not cause it, *or the market it serves*, to experience a shortage of supply." (R. 7318). (Emphasis added). With open access pipeline transportation and mandated transportation by non-"open access" pipelines and the right of first refusal accorded the purchaser's firm customers over any released gas, customers are assured access to sufficient supplies at reasonable prices now and into the future. (R. 7318-19).[12] To this is added the significant requirement that abandonment under GFN is permissible only when there is a particular new customer who has contracted to take the gas at a market responsive price which assures that the gas will get to the market.

[11] Nor is the Commission's rejection of decisions under the Interstate Commerce Act (ICC) faulty.

[12] In addition, requiring individual producers to file abandonment applications and considering those applications on a case-by-case basis is an inadequate solution. That would cause lengthy delays before abandonments could be granted, given the vast number of producers in the nation and the Commission's limited resources. Achievement of the goals of increased production and lower overall prices would thereby be substantially delayed. Thus, granting abandonment in the present proceeding, if the conditions set forth in the Good Faith Negotiation rule are met, is in the interest of the natural gas market as a whole and is necessary to bring about market-responsive prices for old gas and overall lower prices.
R. 7351-52.

Mandatory Transportation Lawful

Under the rules established in the 451 Orders, an interstate pipeline not subject to "open access" regulations that stops purchasing the producer's gas "must transport any gas released due to termination or abandonment" under the GFN procedures. 18 CFR § 270.201 (1988). To facilitate this change of service—from interstate transportation *and* sale to *transportation* only—the Commission provides a "blanket" certificate. This Court's opinion holds this to be unauthorized as imposing "common carrier" responsibilities on the unwilling or reluctant pipeline. Essentially these same arguments were presented and rejected by the D.C. Circuit in the attack on the Commission's "open access" rules in its celebrated *Associated Gas Distributors* case.[13] After first discussing the pertinence of §§ 5, 7, and 16 of the NGA that Court continued, there is "no language in the NGA barring the Commission from imposing common carrier status on natural gas pipelines, and certainly none barring it from imposing on the pipelines a specific duty that happens to be a typical or even core component of such status." 824 F.2d at 997. That Court found no basis for the attacks on "open access" under either the provisions of NGA or its legislative history, 824 F.2d at 997-1001, or under either the NGPA, 824 F.2d at 1001-1003, or the Fifth Circuit's decision in *Fiorida Power and Light v. FERC*, 660 F.2d 668 (5th Cir. 1981).[14] *See* 824 F.2d at 998-99.

[13] 824 F.2d 981 (D.C.Cir. 1987).

[14] This decision if relevantly significant is, of course, binding on me.

Quite apart from the arguments on common carrier status, the Court's opinion errs in disapproving the Commission's order.

First, there seems to be a major misconception. The Commission imposed no new "mandatory" transportation obligation at all. Rather, the Commission required only "a continuation of the pipeline's existing service obligation to move gas to market." [15] Therefore, the pipeline may have been a *merchant* purchasing gas at the wellhead and a *transporter* carrying the gas to its customers. Now, once GFN procedures have failed to result in agreement upon a new price for old gas under existing contracts, the pipeline becomes a *transporter* moving essentially the *same* gas but now purchased by someone else. The critical fact is that the essential transportation service for the same gas to the interstate market remains exactly the same. (R. 7429-30).

Following traditional lines so stressed by the protestants and this Court's opinion, § 7 of the NGA imposes "a continuing regulatory obligation, irrespective of private contractual arrangements, not to abandon any certificated obligations before obtaining authorization from the Commisison to do so." *Panhandle Eastern Pipe Line Co. v. FERC*, 803 F.2d 726, 728 (D.C.Cir. 1986), citing *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d 54 (1979). In the light of this, what the Commission requires is nothing more than that the pipeline, choosing to terminate its gas merchant function under GFN, must neverthless continue to provide its critical transport service.

Finally, as the Commission explains so vividly, (R. 7428-7430), there are practical necessities sustain-

[15] R. 7429 (citation omitted).

ing the administrative reasonableness of the Commission's action. Not to require the pipeline to continue its transportation service would seriously impair, if not completely undercut, the availability of market-priced gas to the market. It would also offset the consequences of the GFN. Significantly the only interstate pipelines subject to this mandatory transportation are those few non-"open access" pipelines. Whatever the rights of these very few [16] non-"open access" pipelines—none involved here—their rights ought not to pull down the whole house of cards as to those already bound [17] to transport under "open access" requirements.

Take or Pay Solution not Mandatorily Required

Probably the most startling part of the Court's opinion is its presuming to direct the Commission to consider, and once and for all to *solve*, a matter so perplexing and complex as the issue of take-or-pay contracts.

[16] All but two of the twenty-one major pipelines are consensually "open access." *See* n.34, Court's opinion.

[17] Ironically, indicating perhaps the simple reflex of opposition by so many to any and every new effort to unscramble natural gas in the fact that joining the Joint Opponents' briefs are a number of party-pipelines who have accepted "open access." *See, e.g., Transcontinental Gas Pipe Line Corp.*, 43 FERC ¶ 61,196 (1988); *Tennessee Gas Pipeline Co.*, 39 FERC ¶ 61,337 (1987); *Natural Gas Pipeline Co. of America*, 39 FERC ¶ 61,153 (1987); *Williams' Natural Gas Co.*, 43 FERC ¶ 62,171 (1988); and *ANR Pipeline Co.*, 44 FERC ¶ 61,126 (1988).

Granted that it is a serious problem and one which needs a solution if—and the if may be a very big one—it can be solved independently of the ultimate insolvency of major pipeline takers and payers.

As this very Court has recognized in rejecting similar arguments, the take-or-pay issue is a discreet matter, "which is being addressed in other proceedings before the Commission and through other means." *Transwestern Pipeline Co. v. FERC*, 820 F.2d 733, 744 (5th Cir.1987).[18]

Indeed, the demand that the Commission—under penalty of forfeiting its judgmental conclusion on increased price for old gas, abandonment and mandatory transportation—consider and then solve this problem of which Congress has been acutely aware, and has similarly ducked, is, most charitably, audacious. So audacious is it that it approaches a similar demand by some court someplace that either Congress or the Department of Defense solve the problem of terrorism as a condition to appropriating funds for the maintenance and upkeep of the prisoner stockade at Fort Sam Houston, Texas.

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[18] The Commission's brief advises the Court that the Commission is particularly addressing these issues in the proceedings on remand of *Associated Gas Distributors*, Order No. 500; Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol: Interim Rule and Statement of Policy [Reg. Preambles 1982-1985], III FERC Stats. & Regs. ¶ 30,761 (1987), *modified and reh'g denied*, Order No. 500-B, III FERC Stats. & Regs. ¶ 30,772, *further modified*, Order No. 500-C, III FERC Stats. & Regs. ¶ 30,786 (1987), Order No. 500-D, III FERC Stats. & Regs. ¶ 30,800 (March 8, 1988), *reh'g denied*, Order No. 500-E, 43 FERC ¶ 61,234 (May 6, 1988), 53 Fed.Reg. 16,859 (May 12, 1988); petitions for review filed *sub nom. American Gas Association v. FERC*, (D.C. Cir. No. 87-1588).

This is contrary to the demands not only of administrative law, but of the review of legislation, state or federal. The Supreme Court has long recognized that "[e]vils in the same field may be of different dimensions and proportions, requiring different remedies. . . . [O]r the reform may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind." *Williamson v. Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 489, 75 S.Ct. 461, 465, 99 L.Ed. 563 (1955); *see also Schweiker v. Wilson*, 450 U.S. 221, 238, 101 S.Ct. 1074, 1084, 67 L.Ed.2d 186 (1981).

Additionally, the Commission provides pipelines with the means to address take-or-pay problems within the context of its rulemaking. First, pipelines are given something tangible (higher old gas prices) to bargain against take-or-pay liability. Second, when producers, under GFN, seek to raise an old gas price, pipelines can require the direct renegotiation of the sellers' high-cost gas sales that are being sold under mixed contracts. Third, the pipeline can terminate its contract obligations as to both the old gas and high-cost gas sold under mixed contracts. In short, as the Commission found, the pipelines were given substantial bargaining leverage against producers' uneconomic contracts.[19]

Tag Ends

Like the Court in its opinion, I find undeserving of specific comment the other attacks on the Commission's 451 Orders.

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[19] The Commission's brief advises that to date under the Commission Order No. 500 series, eight pipelines have reached in the aggregate over $3.9 billion in settlements of take-or-pay liability. *See* Commission's brief, at note 55 (citing specific cases).

Where it All Ends

Committed, as we are, to the Commission's necessitous right of experimentation in a matter so complex and nearly beyond congressional solution, this Court's action in nullifying the 451 Orders is an unauthorized intrusion into a field which neither Article III nor legislation commands.

I therefore, respectfully dissent.

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 86-4940

MOBIL OIL EXPLORATION and PRODUCING SOUTHEAST, INC., *et al.*, PETITIONERS

versus

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

Petitions for Review of an Order of the Federal Energy Regulatory Commission

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ON PETITIONS FOR REHEARING AND SUGGESTIONS FOR REHEARING EN BANC

(Opinion 9/15/89, 5 Cir., 198 , —— F.2d ——)

(Dec. 15, 1989)

Before CLARK, Chief Judge, BROWN and JOHNSON, Circuit Judges.

PER CURIAM:

(✓) The Petitions for Rehearing are DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc. (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestions for Rehearing En Banc are DENIED. Judge Brown continues in his dissent.

ENTERED FOR THE COURT:

/s/ Sam Johnson
United States Circuit Judge

APPENDIX C

STATUTORY AND REGULATORY PROVISIONS INVOLVED

A. RELEVANT STATUTORY PROVISIONS

1. Section 4(a) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717c(a), provides:

> (a) Just and reasonable rates and charges
>
> All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

2. Section 7(b) of the Natural Gas Act of 1938, as codified at 15 U.S.C. 717f(b), provides:

> (b) Abandonment of facilities or services; approval of Commission
>
> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

3. Section 104 of the Natural Gas Policy Act of 1978, as codified at 15 U.S.C. 3314, provides:

> § 3314. Ceiling price for sales of natural gas dedicated to interstate commerce
>
> (a) Application
>
> In the case of natural gas committed or dedicated to interstate commerce on November 8, 1978, and for which a just and reasonable rate under the Natural Gas Act [15 U.S.C. 717 et seq.] was in effect on such date for the first sale of such natural gas, the maximum lawful price computed under subsection (b) of this section shall apply to any first sale of such natural gas delivered during any month.
>
> (b) Maximum lawful price
>
> (1) General rule
>
> The maximum lawful price under this section for any month shall be the higher of—
>
> (A) (i) the just and reasonable rate, per million Btu's, established by the Commission which was (or would have been) applicable to the first sale of such natural gas on April 20, 1977, in the case of April 1977; and
>
> (ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month, or
>
> (B) any just and reasonable rate which was established by the Commission after April 27, 1977, and before November 9,

> 1978, and which is applicable to such natural gas.
>
> (2) Ceiling prices may be increased if just and reasonable
>
> The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—
>
> (A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and
>
> (B) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

4. Section 106 of the Natural Gas Policy Act, as codified at 15 U.S.C. 3316, provides in pertinent part:

> § 3316. Ceiling price for sales under rollover contracts
>
> (a) Interstate rollover contracts
>
> In the case of the first sale under any rollover contract of natural gas which was committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—
>
> (1) (A) in any case of the month in which the effective date of such rollover contract occurs, the just and reasonable rate, if any, per million Btu's, established by the Commission and applicable on such date to the natural gas subject to the expired contract; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(2)(A) $0.54 per million Btu's, in the case of April 1977; and

(B) in the case of any month thereafter, the maximum lawful price, per million Btu's, precribed under this paragraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month. For purposes of this subsection, the term "rollover contract" includes any contract which would have been a rollover contract but for the fact that the expiration of the previous contract occurred prior to November 8, 1978.

(b) Intrastate rollover contracts

(1) General rule

In the case of any first sale under any rollover contract of natural gas which was not committed or dedicated to interstate commerce on November 8, 1978, the maximum lawful price under this subsection for such natural gas delivered during any month shall be the higher of—

(A)(i) the maximum price paid under the expired contract, per million Btu's, in the case of the month in which the effective date of such rollover contract occurs; and

(ii) in the case of any month thereafter, the maximum lawful price, per

million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month; or

(B)(i) $1.00 per million Btu's, in the case of April 1977; and

(ii) in the case of any month thereafter, the maximum lawful price, per million Btu's, prescribed under this subparagraph for the preceding month multiplied by the monthly equivalent of the annual inflation adjustment factor applicable for such month.

(2) Certain State or Indian production or royalty shares

* * * * *

(c) Ceiling price may be increased if just and reasonable

The Commission may, by rule or order, prescribe a maximum lawful price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(1) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(2) just and reasonable within the meaning of the Natural Gas Act [15 U.S.C. 717 et seq.].

B. RELEVANT REGULATORY PROVISIONS ADOPTED BY ORDER NO. 451, AS AMENDED

1. 18 C.F.R. 157.301 provides:

§ 157.301 Blanket certificate authority, pregranted abandonment, and reporting requirements.

(a) *Blanket certificate authority.* Any first seller of natural gas that is authorized to abandon the sale of gas under § 157.30 (c) or (d) or the good faith negotiation procedures set forth in § 270.201 of this chapter, is granted a certificate of public convenience and necessity to sell such gas for resale in interstate commerce, subject to the reporting requirements of paragraph (c) of this section.

(b) *Pre-granted abandonment.* Any first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made.

(c) *Reporting requirement.* Any first seller who makes sales under the blanket certificate authority of this section must file a report with the Commission not later than April 1 of each year providing the following information with respect to any sales under that certificate initiated during the preceding calendar year:

(1) Name of former purchaser;
(2) Name of new purchaser;
(3) Location of sale (field, block, county, state, etc.);
(4) Contract date;

(5) Contract term;
(6) Average price; and
(7) Estimated annual sales volume (mcf).

(d) *Waiver of rate filing requirements.* The rate filing requirements of §§ 154.92 and 154.94 of this chapter are waived for sales under a certificate granted by this section.

2. 18 C.F.R. 270.201 provides:

Good faith negotiation procedures.

(a) *Applicability definitions, and general rules.* (1) This section applies to requests for renegotiation of the price of old gas sold under an existing contract.

(2) For purposes of this section:

(i) "Old gas" means natural gas which, if sold, would be subject to a maximum lawful ceiling price under section 104 or 106(a) of the NGPA.

(ii)(A) "Existing contract" means a contract in effect on July 18, 1986, or an expired contract pursuant to which sales of natural gas are continuing on that date under the service obligation of a certificate of public convenience and necessity, that includes the sale of any old gas and provides authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price.

(B) An existing contract includes the sale of old gas if, on July 18, 1986, the contract encompasses the sale of any gas that has not been abandoned under section 7(b) of the Natural Gas Act and which, if sold, would be priced as old gas, whether or not any old gas is sold on that date.

(iii) The terms "first seller" and "party to a contract" include:

(A) An owner of a working interest in an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" of gas, as defined in section 2(21) of the NGPA; and

(B) An operator of an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" on behalf of any owner of a working interest in the lease that does not have such a relationship.

(3) (i) Any existing contract under which old gas is sold may be renegotiated or amended at any time to provide for a price up to the alternative maximum lawful price under § 271.402(c)(7)(i) of this chapter without using the good faith negotiation procedures.

(ii) A price for old gas that exceeds the otherwise applicable maximum lawful price under § 271.402 of this chapter may be collected under an existing contract only if the first seller and purchaser agree upon a price up to the alternative maximum lawful price under § 271.402(c)(7)(ii) in accordance with this section.

(4) A party to an existing contract may not request a nomination of a price under the provisions of this section for any gas sold under the contract if that party:

(i) And the purchaser or first seller have renegotiated the price or any other term for the sale of any old gas under the contract after July 18, 1986, without using the good faith negotiation procedures of this section, and have not agreed in writing to preserve their rights under this section;

(ii) Has previously requested nomination of a price under paragraph (b)(1) of this section for any gas sold under the contract; or

(iii) Has been requested under this section to nominate a price for any gas sold under the contract, and the last date has passed under paragraphs (b)(2) or (b)(3) of this section to request the other party to nominate a price for gas sold under the contract.

(5) (i) A first seller that validly assigns or otherwise transfers gas subject to an existing contract on or after June 3, 1987 may not request a nomination of price under the provisions of this section for any gas sold under any existing contract with that purchaser unless the purchaser's right to renegotiate, under the provisions of this section, the terms of sale of the assigned gas are unaffected by the assignment.

(ii) A first seller to whom gas subject to an existing contract is validly assigned, or otherwise transferred, on or after June 3, 1987 may not request nomination of a price under the provisions of this section for the assigned gas, unless the purchaser's right to renegotiate, under the provisions of this section, the terms of sale of all gas sold under any existing contract between the purchaser and the assignor on June 3, 1987 are unaffected by the assignment.

(6) Any request for nomination of a price under this section, any nomination of a price in response to such a request, and any notice of abandonment of sales or termination of purchases under this section must be sent by U.S. mail, return receipt requested.

(7) Any deadline under this section for requesting a nomination of a price, or for nominat-

ing a price in response to such a request, may be extended by mutual agreement of the parties in writing. Any notice required under this section to be given before a first seller or purchaser abandons or terminates sales or purchasers may be shortened by mutual agreement of the parties in writing.

(8) A party nominating a price may propose a change in any other term of the existing contract, and for purposes of this section, the terms "nominated price" and "nomination" may include such a proposed change.

(b) *Requests for negotiation and nomination of price.*

(1)(i) At any time after January 23, 1987, a first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying old gas under any existing contract by submitting a written request to the purchaser, and may specify the wells or category of wells under each contract for which the first seller requests a renegotiated price.

(ii) When requesting a nomination of a price under this paragraph, a first seller may also request the purchaser to provide the first seller with a current list of all of the purchaser's firm sales customers, including the name and address of an employee or agent responsible for negotiating purchases of natural gas on behalf of the customer. The purchaser must send the list of customers to the first seller within 30 days after receiving the request and must include a certification of its completeness and accuracy. The list must be sent by U.S. mail, return receipt requested.

(2) Within 30 days after receiving a request for nomination of a price under paragraph (b)(1) of this section, the purchaser may request the first seller to nominate a price at which the first seller is willing to continue selling any gas, including old gas for which the first seller has requested a nomination of price by the purchaser, under any existing contract with the purchaser that includes the sale of any old gas, whether or not named in the first seller's request, by submitting a written request to the first seller.

(3) Within 30 days after receiving a request from a purchaser for nomination of a price for any gas under a contract that is not named in the first seller's request and that includes the sale of any old gas, the first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying any old gas under that contract, including old gas for which the purchaser has requested a nomination of price by the first seller, by submitting a written request to the purchaser.

(4) A first seller's request for nomination of a price under paragraph (b)(1) of this section constitutes an offer to release the purchaser from its contract obligation to purchase any gas sold under any existing contract with the first seller, whether or not named in the first seller's request, that includes the sale of any old gas.

(5)(i) The provisions of this paragraph apply when (A) a first seller validly assigns (or otherwise transfers) gas subject to an existing contract to another first seller on or after June 3, 1987 and (B) the assignor or assignee is eligible to request nomination of a price under paragraph (b)(1) of this section.

(ii) If the assignor requests nomination of a price, under paragraph (b)(1) of this section, for old gas sold under any contract between it and the purchaser, the purchaser may request nomination of a price under paragraph (b)(2) of this section for any gas which on June 3, 1987 was subject to an existing contract between the purchaser and the assignor.

(iii) If the assignee requests nomination of a price under paragraph (b)(1) of this section for the assigned gas, the purchaser may request nomination of a price for any gas which on June 3, 1987 was subject to an existing contract between the assignor and the purchaser, but the purchaser may not request nomination of a price for any other gas.

(iv) If the assignee requests nomination of a price under paragraph (b)(1) of this section for old gas other than the assigned gas, the purchaser may not request nomination of a price under paragraph (b)(2) of this section for the assigned gas.

(v) The purchaser must address any requests for nomination of a price authorized by paragraphs (b)(5) (ii) or (iii) of this section to the first seller currently selling it the gas for which nomination of a new price is requested.

(vi) If a first seller receives a request for nomination of a price authorized by paragraph (b)(5) (ii) or (iii) of this section with respect to an existing contract for which it did not make a nomination request under paragraph (b)(1) of this section, the first seller may request under paragraph (b)(3) of this section that the purchaser nominate a price for any old gas sold under that contract, whether or not the contract

was named in the nomination request of the assignor or assignee under paragraph (b)(1) of this section.

(c) *No response to request for nomination.* (1) If the purchaser does not nominate a price in writing within 60 days after receiving the first seller's request for nomination of a price, the first seller may offer to sell all or part of the gas named in its request for nomination to a new purchaser. The first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas if the first seller enters into a written contract for the sale of all or part of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(2) If the first seller does not nominate a price in writing within 60 days after receiving the purchaser's request for nomination of a price, the purchaser may terminate its purchases of all or part of the gas named in its request for nomination at any time upon 60-days written notice to the first seller.

(d) *Purchaser's nomination of highest price.* If the purchaser nominates in writing the highest price to which an existing contract price could escalate with the purchaser's agreement under § 271.402(c)(7)(ii) of this chapter, and the purchaser does not propose a change in any term of the contract, sales must continue at the nominated price under the terms of the existing contract.

(e) *Purchaser's nomination of lower price; first seller's options.* (1) If the purchaser nominates in writing a price less than the highest

price to which the existing contract price could escalate or proposes a change in any other term of the contract, the first seller must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the first seller does not accept the purchaser's nominated price in writing within 30 days, the nominated price is deemed rejected.

(2) If the first seller accepts the nominated price, sales must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the first seller rejects the nominated price, the first seller must continue sales to the purchaser at the existing price until the sale of the gas is abandoned under this paragraph. At any time after a rejection, the first seller may offer to sell to a new purchaser all or part of the gas for which no price is agreed upon under this paragraph.

(4) A first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of any gas offered under this paragraph for which the first seller enters into a written contract with a new purchaser after any necessary compliance with paragraph (g) of this section.

(f) *First seller's nomination of price; purchaser's options.* (1) If the first seller nominates a price in writing in response to the purchaser's request under paragraph (b)(2) of this section, the purchaser must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the purchaser does

not accept the first seller's nominated price in writing within 30-days, the nominated price is deemed rejected.

(2) If the purchaser accepts the nominated price, purchases must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the purchaser rejects the nominated price, the purchaser may at any time terminate its purchases of all or part of the gas named in its request for nomination upon 60-days written notice to the first seller.

(4) The terms of the existing contract apply until the first seller's nominated price or terminates purchases of the gas under this paragraph.

(5) A first seller is authorized to abandon sales of the gas to the purchaser if the purchaser terminates purchases of gas under this section and the first seller enters into a written contract for the sale of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(g) *Existing firm sales customers' right of first refusal*—(1) *General rule.* (i) If the first sellers offers to sell gas subject to release due to termination or abandonment under paragraphs (c), (e), or (f) of this section ("offer") to a new purchaser that is not an existing firm sales customer of the existing purchaser, the first seller must present the same offer to all existing firm sales customers, if:

(A) The existing purchaser is not subject to non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter, and;

(B) The offer encompasses the sale of any gas subject to the Commission's jurisdiction under section 1(b) of the Natural Gas Act and is substantially accepted in principle by the new purchaser in an arms-length transaction.

(ii) Any existing firm sales customer has a right of first refusal to purchase the gas under the terms of the offer. The offer must be presented in accordance with the provisions of this paragraph.

(2) *Making the offer.* The offer to a new purchaser that is not an existing firm sales customer must be presented to all such customers of the existing purchaser not later than 10 days after the offer is substantially accepted in principle by the new purchaser. The offer must be tendered by U.S. mail, return receipt requested.

(3) *Acceptance and rejection of offer; no counteroffer.* (i) An existing firm sales customer must accept the offer in writing within 20 days after receiving the offer. The offer is deemed accepted when it is signed and placed in the U.S. mail, return receipt requested. If the offer is not accepted by an existing firm sales customer within 20 days of its receipt, the offer is deemed rejected.

(ii) Any written counteroffer by an existing firm sales customer constitutes a rejection.

(iii) If the first seller receives more than one acceptance from an existing firm sales customer, the first seller may determine which such customer will become the new purchaser.

(4) *Termination of right of first refusal.* If no existing firm sales customer accepts the offer made under this paragraph within 20 days of

receiving the offer, the first seller may execute a written contract with the new purchaser that substantially accepted the offer before it was sent to the existing firm sales customers. Such written contract with a new purchaser is not subject to a right of first refusal.

(5) *Definition.* For purposes of this section, "existing firm sales customer" means a customer with which the existing purchaser has a contract for the sale of gas not subject to prior claim by another customer or another cass of service, and at the same priority as any other class of firm service, which is in effect on the date a new purchaser substantially accepts in principle an offer under paragraph (g)(1) of this section.

(h) *Transportation by existing pipeline purchaser.* A purchaser that is an interstate pipeline not subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter must transport any gas released due to termination or abandonment under this section, on behalf of any shipper, to any existing customer of the interstate pipeline or to any pipeline to which the interstate pipeline is interconnected, and in accordance with § 284.225 of this chapter, if the purchaser:

(1) Does not submit a timely nomination of a price for gas under paragraph (c)(1) of this section in response to the first seller's request for nomination of a price;

(2) Nominates a price under paragraph (e)(1) of this section that is less than the highest price to which its existing contract price could escalate if it were a new or amended contract;

(3) Terminates purchases of gas under paragraph (c)(2) of this section when the first

seller does not submit a timely nomination of a price; or

(4) Terminates purchases of gas under paragraph (f)(3) of this section after rejecting a price for gas nominated by the first seller.

3. 18. C.F.R. 271.402 provides in pertinent part:

Maximum lawful prices.

* * * * *

(c) *Applicable higher rates.*

* * * * *

(3) In the case of any first sale under any rollover contract to which this subpart applies, the maximum lawful price for the month in which the effective date of such rollover contract occurs is the highest of:

(i) The maximum lawful price applicable to the expiring contract in the month in which the rollover contract becomes effective;

(ii) The price specified in Table II of § 271.101(a) for interstate rollover gas; or

(iii) The price specified in Table II of § 271.101(a) for post-1974 gas if the rollover contract becomes effective after July 18, 1986.

* * * * *

(7) The maximum lawful price, per MMBtu, for the first sales of all categories of gas otherwise subject to lower maximum lawful prices under this subpart is the price specified in Table II of § 271.101(a) for post-1974 gas, if the price is established:

(i) Under a contract or contract amendment executed after July 18, 1986; or

(ii) In accordance with the good faith negotiation procedures of § 270.201 of this chapter.

4. 18 C.F.R. 271.602 provides in pertinent part:

Maximum lawful price.

(a) *General rule.* The maximum lawful price for a first sale of natural gas under an intrastate rollover contract to which section 106(b)(1) of the NGPA applies shall be the highest of:

(1)(i) The maximum lawful price, per MMBtu, paid under the expired contract, in the month in which the rollover contract becomes effective; and

(ii) In any month after the month in which the rollover contract becomes effective, the maximum lawful price, per MMBtu, prescribed under this paragraph for the preceding month adjusted for inflation in accordance with § 271.102;

(2) The alternative maximum lawful price specified in Table I of § 271.101(a) for certain intrastate rollover gas; or

(3) The price specified in Table II of § 271.101(a) for post-1974 gas, if the price is established under a contract or contract amendment executed after July 18, 1986.

(b) *Certain State or Indian production or rayalty shares.* The maximum lawful price, per MMBtu, for natural gas to which section 106(b)(2) of the NGPA (relating to certain State or Indian natural gas production or royalty interests) applies shall be the price specified for new natural gas (Subpart P of Part 271) in Table I of § 271.101(a).

(c) *Qualified production enhancement gas.* For purposes of paragraph (a)(1)(i) of this

section, the maximum lawful price, per MMBtu, paid under the expired contract is deemed to include any amount paid by reason of a maximum lawful price allowed under § 271.704 (relating to qualified production enhancement gas.)

APPENDIX D

PARTIES TO THE PROCEEDINGS

The petitioners and intervenors in the court of appeals were:

American Gas Association
American Iron and Steel Institute
American Public Gas Association
Amoco Production Company
Anadarko Petroleum Corporation
ANR Pipeline Company
Apache Corporation
ARCO Oil and Gas Company
A Division of Atlantic Richfield Company
Arizona Public Service Company
Arkla Energy Resources
A Division of Arkla, Inc.
Associated Gas Distributors
Atlanta Gas Light Company
Bethlehem Steel Corporation
Can-Am Corporation
Champlin Petroleum Company
(now Union Pacific Resources Company)
Chevron U.S.A. Inc.
Cities Service Oil and Gas Corporation
Colorado Interstate Gas Company
Columbia Nitrogen Corporation
Conoco Inc.
El Paso Natural Gas Company
Elizabethtown Gas Company
Exxon Corporation
Federal Energy Regulatory Commission
Florida Cities
(Ft. Pierce Utilities Authority
City of Gainesville

Gainesville Regional Utilities
City of Homestead
Kissimmee and Lakeland
The Orlando Utilities Commission
Sebring Utilities Commission
Cities of St. Cloud, Starke, Tallahassee and Vero Beach, Florida)
General Service Customer Group
Georgia Industrial Group
Independent Petroleum Association of America
Interstate Natural Gas Association of America
KN Energy, Inc.
Laclede Gas Company
Marathon Oil Company
Maryland People's Counsel
Memphis Light, Gas and Water Division, City of Memphis, Tennessee
Michigan Constolidated Gas Company
Minnesota Department of Public Service
Missouri Public Service Commission
Mobil Exploration and Producing North America Inc.
Mobil Exploration & Producing U.S. Inc.
Mobil Oil Corporation
Mobil Oil Exploration & Producing Southeast Inc.
Mobil Producing Texas & New Mexico Inc.
National Association of State Utility Consumer Advocates
Natural Gas Pipeline Company of America
Northern Natural Gas Company Division of Enron Corporation
Northern States Power Company
North Shore Gas Company
Northwest Central Pipeline Corporation (now Williams Natural Gas Company)

Nipro, Inc.
Office of Consumer Advocate, State of Pennsylvania
Office of Consumers' Counsel, State of Ohio
OXY USA Inc.
Pacific Gas and Electric Company
Panhandle Eastern Pipe Line Company
Paul Lime Division
Pennzoil Company
Phelps Dodge Corporation
Phillips Petroleum Company
Phillips 66 Natural Gas Company
Plains Petroleum Company
Plains Petroleum Operating Company
Process Gas Consumers Group
Public Service Commission of the State of New York
Public Service Electric and Gas Company
Public Utilities Commission of the State of California
Salt River Project Agricultural Improvement and Power District
Shell Offshore Inc.
Shell Western E&P Inc.
Southern California Gas Company
Southwest Gas Corporation
Sun Exploration and Production Company
Tenneco Oil Company
Tenngasco Corporation
Tennessee Gas Pipeline Company
Texaco Inc.
Texas Eastern Transmission Corporation
Texas Gas Transmission Corporation
The Kansas Power and Light Company
The Peoples Gas Light and Coke Company
The State of Michigan and Michigan Public Service Commission

Transcontinental Gas Pipe Line Corporation
Trunkline Gas Company
Union Gas Systems
Union Pacific Resources Company
Union Oil Company of California
United Distribution Companies
United Gas Pipe Line Company

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